June 20, 2011

Antitrust Law in the Wake of the Recent Financial Crises: A Critical Analysis of the Status Quo and a Roadmap for Reinforcing Enforceability

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Antitrust Law in the Wake of the Recent Financial Crises: A Critical Analysis of the Status Quo and a Roadmap for Reinforcing Enforceability

by Dr. Ioannis Kokkoris* and Dr. Rodrigo Olivares-Caminal**

ABSTRACT

During the financial crisis companies and markets found themselves in distressed situations. Competition authorities across the globe had to deal with controversial issues such as the application of the failing firm defence in merger transactions as well as assessment of crisis cartels. This chapter considers antitrust policy in periods of crisis, and in particular the ‘failing firm’ defence in merger control and the treatment of crisis cartels. Antitrust policy played a useful role in a period of crisis but might be a secondary concern during such times. This approach is the key to the long-term benefits of competition for consumers and for the economy as a whole in terms of growth and increased productivity.

Keywords: financial crisis, antitrust policy, failing firm defence, crisis cartels, financial constraints defence

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INTRODUCTION

The global financial crisis illustrates that assumptions of market efficiency are misplaced where systemic uncertainty roams the marketplace. As Devlin argues, it reveals that macroeconomic fluctuations cannot be controlled by monetary policy alone.¹ This paper will address the status quo of competition enforcement amidst the financial crisis and will suggest how to enforce antitrust law in such periods in order to ensure the objectives that competition aims at achieving. In particular it shall examine competition enforcement related to crisis cartels and mergers.

The US Federal Trade Commission European Commission, under an economic crisis, has to be really cautious with the application of competition rules by considering the short term restabilisation of the economy but also the long-term development of competition. As John Fingleton, the Chairman of the OFT argues, the crisis brought its own challenges in the temptation to form cartels or to engage in other forms of permissible or non-permissible horizontal competition. In addition, more failing firm defence arguments in mergers would be likely, and the view that loss of competitive rivalry was not significant in the existing economic conditions would be advanced.²

² OECD Summary Record of the discussion on Competition and Financial Markets, DAF/COMP/M(2009)1/ANN4, 10 April 2009, Roundtable 3 on Real Economy and Competition Policy in a Period of Retrenchment, www.oecd.org. Evidence of previous crises illustrates that relaxing competition enforcement can prolong the adverse effects of a crisis. We should note that the policies that prolonged the adverse effects of the Great Depression included policies that were aiming at sustaining high wages, and thus mainly at fixing wages through collective bargaining. The key
We should stress that this paper is not advocating that antitrust policy should be automatically relaxed. The premise behind the analysis presented herein is that competition authorities should be pragmatic in identifying instances where even if some of the strict failing firm defence criteria or of the assessment criteria for efficiencies are not satisfied, competition authorities rather than prohibiting an anticompetitive merger outright, it should consider whether this prohibition may induce severe harm to consumer welfare which is more significant than any likely anticompetitive impact of the merger. Thus, as we shall see later in this paper, a balancing of the two post merger situations need to be considered in order to ensure that the conclusion of the merger assessment will induce an as beneficial result as possible. Similarly, regarding cartels, certain agreements can have beneficial effects for markets during a crisis. Adopting a strict approach to such agreements and/or imposing high fines may risk the viability of undertakings and/or industries as a whole.

In the following parts of this paper, we shall analyse how antitrust law should be enforced in periods of crises in the US and EU as regards mergers and crisis cartels. A pragmatic, antitrust policy which takes into account the implications of crises will ensure the maximisation of consumer welfare in cases where unless some competition principles are applied more leniently

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feature of the policies involved in the New Deal was not government sponsored collusion *per se*, but rather the policy linking high wages and ability to collude. In addition, there was a full suspension of the enforcement of antitrust law unlike the EC policy of the 80s and 90s where coordinated reduction of productive capacity was on a number of cases accepted as a means to sustain the effects of the crisis. Had such an approach been followed, rather than a full suspension of antitrust policy the outcomes on the recovery of the economy may not have been so slow.
the result shall be inefficiencies created in the market, inefficiencies that can have long term adverse implications after the crisis has come to an end.

Turning briefly to the objectives of competition legislation, in the EU and US, the notion of harm to consumers should be read in conjunction with that of harm to the process of competition, although the two notions are quite distinct. Moreover, consumer welfare is an aim which should be viewed dynamically, i.e. by examining also its dimensions on a mid and long-term basis. In contrast to American antitrust law, there has been continuing debate over the concept of consumer welfare referring to a narrower or broader meaning.

Promotion of consumer welfare has traditionally been considered as one of the aims, not the sole aim of antitrust, both in the United States and in Europe. In the United States the Federal Trade Commission acts to ensure that markets operate efficiently to benefit consumers. In the UK the Office of Fair Trading declares that the OFT’s goal is to make markets work well for consumers. Most academics seem to agree that consumer protection is the prevailing aim of antitrust legislation.

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3 V. Mertikopoulou, ‘DG Competition’s discussion paper on the application of Article 102 of the EC Treaty to exclusionary abuses: the proposed economic reform from a legal point of view’, (2007), ECLR, 28(4), 241-251, page 242. In antitrust law the primary role of the consumer welfare standard is to verify the goals of antitrust policy and to delineate the general legal framework of antitrust law enforcement by establishing the basis for the standard of proof required in investigation and litigation.


5 Annex 1 presents a table (taken from the ICN Report) of the objectives of unilateral conduct laws identified in the responses of the jurisdictions which were surveyed as part of the ICN Report. The report prepared by the ICN
According to Cseres,

the adoption of the consumer welfare standard vis-à-vis the total welfare standard places consumers’ economic needs and responses to firm behaviour further into the focus of competition law enforcement. It, counterbalances firms’ information advantages, lobbying advantages, the fact they are better represented, as well as their first mover advantages in selecting the strategic moves they pursue. The consumer welfare standard seems, from both the legal and political aspect, an appropriate standard of enforcement.\(^6\)

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MERGER ENFORCEMENT AMIDST CRISES

According to the OECD Report\(^7\) merger activity is expected to increase once financial markets are restored. The crisis is likely to result in a higher incidence of failing firm defenses put forward as a reason to clear anticompetitive mergers. Mergers and acquisitions have become very difficult to fund due to the credit crunch and at the same time, the crisis is likely to increase the number of failing firms and lead to attempts of consolidation in sectors of the economy.

Because in a period of crisis the most sensible mergers and those most frequently presented to competition authorities, are horizontal enhancing the ability of the merged entity and in some cases its competitors to impose higher prices (or adopt other types of anticompetitive conduct, such as quality reduction) than would be possible under normal competitive conditions.

The question arises as to the extension of ‘sensitivity’ and flexibility of the European Commission in respect to the application of the failing firm defence, when assessing mergers,\(^8\)

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\(^8\) The Commission considers the following three criteria as relevant for the application of a ‘failing firm defence’. First, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Second, there is no less anti-competitive alternative purchase than the notified merger. There may be the case that buyers may be interested in buying the failing firm’s assets after the firm exits the market. A firm’s exit may also provide the means for new entry in the market. In addition, it may be more beneficial for competition for more than one firm to acquire the assets of the failing firm rather than a single firm acquiring the total of the failing firm’s assets. Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market. Once the conditions for the application of the failing firm defence are fulfilled the merger would not be considered to cause a significant impediment to effective competition in the common market. The
given the current economic crisis. In other words how lenient must the Commission be? Do the conditions for the application of the defence or more generally the antitrust policy rules ought to be loosened during difficult economic times?\(^9\)

The *HBOS/Lloyds* merger is a clear example of the intervention of the UK government in the assessment of mergers in exceptional circumstances. In this case the government intervened\(^10\) and allowed the merger despite the fact that the merger was capable of giving rise to competition concerns. The authorities took into account the bad financial situation of HBOS along with the disadvantages that a failure of a bank entails in terms of consumer confidence and costs and cleared the merger.\(^11\) In fact, the government enabled the Secretary of State to get involved with

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\(^9\) To the question whether the current distressed economic environment make securing antitrust approval for mergers or acquisitions easier than it otherwise might be Akin Gump replied that *antitrust principles will take into account the weakened financial condition of a merging party.* Akin Gump, Strauss Hauer & Feld LLP, *Acquisitions of Distressed Companies: Obtaining Antitrust Merger Clearance Using the Failing and Weakened Firm Defenses.* www.akingump.com.

\(^10\) The UK government could intervene in merger control decisions only in respect to national security and media-related mergers but in this case the government decided to extend the situations where it could intervene by including the category of ‘maintaining the stability of the UK financial system’ in order to be able to intervene in Lloyds TSB/HBOS.

\(^11\) It has to be stressed though that in the particular case the failing firm defence was not applicable and therefore was not the basis for the clearance of the merger.
the merger and temporarily countervail competition rules in order to maintain the general financial stability. The UK’s contribution to the OECD mentions that: ‘the market failure in these circumstances is a mismatch of incentives or incorrect signaling – not an ‘excess’ amount of competition. (....) suspending competition law itself creates a market failure and this is not a sound policy response to an existing market failure’.  

The UK government introduced an additional public policy consideration providing for the stability of the UK financial system to be introduced as a policy exception, along with national security, to the referral of relevant merger situations to the Competition Commission under Section 58 of the Enterprise Act 2002 (‘Act’). 

The change in the approach towards mergers, during the recent crisis, is clearly illustrated by the treatment of the Lloyds/HBOS merger. In looking at the Lloyds/HBOS merger the OFT’s

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13 The Secretary of State made the final assessment of whether to refer the merger to the CC. As we saw earlier in the analysis of the failing firm defence, the OFT recommended reference but the Secretary of State decided to clear the merger. This unusual procedure could not until then be justified for mergers in the financial industry. In fact, the OFT was the only qualified and independent authority specialized in competition issues. However, when the financial stability of the economy is at stake, it becomes understandable and to an extent necessary for governments to temporarily adopt measures necessary to avoid a deepening of the crisis or the crisis becoming systemic. Summary Record of the discussion on Competition and Financial Markets, DAF/COMP/M(2009)1/ANN2, 10 April 2009, Introduction and Roundtable 1 on Principles: Financial Sector Conditions and Competition Policy, www.oecd.org.
counterfactual was its assumption that in the short run the bank would continue to operate with government support. As the OECD Report states, the dramatic shift observed in the case of Lloyds/HBOS is witness to the extraordinary difficulty of the situation and the consequent subordination of competition concerns to stability concerns, at least in the short run.\textsuperscript{14}

The courts, mainly in the EU, have in most instances been negative towards the failing firm defence.\textsuperscript{15} However, there have been some landmark cases which have formulated the development of the concepts of failing firm defence and failing division defence. These decisions by the competition authorities and courts along with the guidelines issued by the competition authorities have provided the framework within which the request for such a defence must be assessed.

The concept and the condition of the failing firm defence were discussed at length in the Commission’s decision in \textit{Kali und Salz}.\textsuperscript{16} The Commission stated that a merger which should normally be considered to lead to the creation or reinforcement of a dominant position on the part of the acquiring firm can be regarded as not causing such a position in the market if, even in the event of the merger being prohibited, the acquirer would inevitably achieve or reinforce a dominant position. Thus, there is a lack of causality between the concentration and the deterioration of the competitive structure if.\textsuperscript{17}

\textsuperscript{14} Competition and Financial Markets, OECD Report, 2009, p. 32.

\textsuperscript{15} Albeit a small number of cases where the defence has been invoked.


\textsuperscript{17} This paper refers to these three criteria as: the \textit{Kali und Salz} criteria.
1. the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking,

2. the acquiring undertaking would take over the market share of the acquired undertaking if it were forced out of the market,

3. there is no less anticompetitive alternative purchase.\(^{18}\)

A fundamental step in the development of the failing firm defence for the Commission was the case *BASF/Eurodiol/Pantochim.*\(^{19}\) The case was decided before the publication of the EU

\(^{18}\) On appeal, the ECJ stated that a failing firm defence could be accepted if the competitive structure resulting from the concentration would deteriorate in a similar fashion even if the concentration did not proceed. Thus, the approach taken by the ECJ was wider than the conditions set out in Commission’s *Kali und Salz* decision. The ECJ’s reasoning seems unduly restrictive since it could permit the approval of a monopoly but block transactions that give rise to less concentrated markets. The ECJ further stated that *the criterion of absorption of market shares, although not considered by the Commission as sufficient in itself to preclude any adverse effect of the concentration on competition, therefore helps to ensure the neutral effects of the concentration as regards the deterioration of the competitive structure of the market. This is consistent with the concept of causal connection set out in Article 2(2) of the Regulation.* See further: Cases C-68/94 and C-30/95 *France v. Commission, Societe Commerciale es Potasses et de l’Azore (SCPA) v. Commission* [1998] ECR I-1375, [1998] 4 CMLR 829, para 116. The ECJ annulled the Commission’s decision due to erroneous findings concerning the collective dominant position on the non-German markets within the Community. See also Levy N. ‘The Control of Concentrations Between Undertakings’, in V. Korah Cases and Materials on EC Competition Law, 2nd ed., (Oxford: Hart Publishing, 2001), page 614.

Guidelines. In *BASF* the Commission refined the *Kali und Salz* criteria. The Commission indicated that the approach taken by the Court of Justice in *Kali und Salz* is wider than the criteria set out in the Commission’s decision. According to the Court of Justice, the existence of a causal link between the concentration and the deterioration of the competitive structure of the market can be excluded and so a merger can be regarded as a rescue merger only if the competitive structure resulting from the concentration is expected to deteriorate in similar fashion even if the concentration were not allowed to proceed.

The Commission stated that for the application of the rescue merger, two conditions must be satisfied:

1. the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking; and

2. there is no less anti-competitive alternative purchase.

In *BASF*, in addition to the first two criteria, it was necessary to establish that:

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21 i.e. application of the failing firm defence.

22 Case COMP/M.2876 - *Newscorp/Telepiù*, [2004], OJ L110/73, para 207.
3. the assets to be purchased would inevitably disappear or exit from the market in the absence of the merger.\textsuperscript{23}

The Commission cleared the merger after comparing the level of competition likely to result from the merger with the level of competition likely to result from the exit of the failing firm and not with the \textit{status quo}.\textsuperscript{24} The Commission once more stated that the application of the concept of the ‘rescue merger’ requires that the deterioration of the competitive structure through the merger is at least no worse than in the absence of the merger.\textsuperscript{25}

Finally, in Newscorp\textsuperscript{26} the Commission considered that it had not been able to demonstrate that there is no causal link between the concentration and the effect on competition, because conditions of competition could be expected to deteriorate to a similar or identical extent even without the concentration in question. However, the Commission took into account that allowing the merger subject to appropriate conditions will be more beneficial to consumers than a disruption caused by a potential closure of Stream. Thus, the Commission took into account the overall market conditions (i.e. chronic financial difficulties of both companies, specific features of Italian market) in clearing the merger. In this case, the European Commission adopted a more

\textsuperscript{23} Case COMP/M.2876 - \textit{Newscorp/Telepiù}, [2004], OJ L110/73, paras 207-208.
\textsuperscript{26} Case COMP/M.2876 - \textit{Newscorp/Telepiù}, [2004], OJ L110/73.
lenient approach in this merger involving a division of a firm, by taking into account the specific conditions and features of the market in clearing the merger.

In the US the legislative history of revision of the Clayton Act by the Celler-Kefauver Act of 1950 eliminated any doubts concerning the validity of the failing firm defence. The *International Shoe* case was the base for the abovementioned amendment. The US Supreme Court subsequently reaffirmed the validity of the defence in the case law.

The company, if allowed to fail, can act in accordance with Chapter 11 of the USBC and still be present in the market. The reorganization process is not costless and shareholders and creditors suffer losses. The companies can be reorganised and fail, ceasing the capacity and liquidating the assets, thus, causing competitive loss as regards output and loss of jobs. Hence, the second element of the failing firm defence requires the firm to prove that ‘it would not be able to reorganise successfully’. This ensures that the firm does not only face the short-term difficulties, but is also not viable in the long-term.

An additional criterion for the acceptance of the failing firm defence in the US is that there must be no other prospective purchaser. In other words, this condition refers to an alternative buyer that would pose less severe danger to competition. Furthermore, this buyer must make a reasonable offer. This offer is defined as ‘any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets - the highest valued use outside the relevant market or equivalent offer to purchase the stock of the failing firm - will be regarded as a
reasonable alternative offer’. Thus, the alternative buyer needs only offer more than the liquidation value and be able to keep the assets operating in the markets, even though the alternative purchaser may have less to offer in the way of improving the efficiency of the failing firm than the prospective competitor purchaser. The competition authorities should consider whether the alternative purchaser has the capability to run the failing firm as a competitive, ongoing business, including infusions of capital that will ensure the viability of the failing firm.28

By rating the least anticompetitive alternative in liquidation value terms, the satisfaction of the failing firm defence criteria is biased in favour of non-market participants. Any efficiencies that a potential competitor-purchaser might generate from the merger may be unnecessarily sacrificed. Furthermore, a non-market participant may simply seek a revenue stream rather than to operate as an effective competitor by making long term investment plans.29 Many firms that purchase a distressed business may intend to ensure a revenue stream and not to compete vigorously.

The question arises why the competitor is willing to pay substantially more than the out-of-market firm. An acquiring competitor’s offer is higher due to the fact that it includes a market power premium - a payment for expected increase in the market power. The competitor-purchaser’s willingness to pay more than the outsider more likely reflects an efficiency premium


than a market power premium. The reason for purchasing an unprofitable firm may be the possibility of profits from increased concentration through oligopolistic interdependence. By making an unprofitable company a good investment, the acquiring company believes that it can reduce its costs and/or improve product lines.

The lack of an alternative purchaser must be established by good faith efforts to find another purchaser. It is required that the failing firm has made a good faith effort to obtain offers from other firms that would keep the failing firm on the market while making a less serious threat to competition. Thus, the failing firm must explore the alternative merger possibilities and seek out the *bona fide* offers. Current policy towards failing firm defence may prefer systematically alternative purchasers that are unlikely to offer the same efficiencies that a competitor purchaser may offer. In addition, the defence may induce companies to be in a severe state of decline before they qualify for the defence.

Thus, the requirement to make a good faith effort to find an alternative purchaser safeguards against a loss in competition. However, the alternative purchaser may have much less to offer in the way of improving the efficiency of the acquired firm than the prospective competitor-purchaser. In addition, there is concern that the competitor’s offer is higher because it includes a market power premium, a payment for anticipated gains in market power. There could be a market power premium, or an efficiency premium or both. The problem is that it is difficult to separate them. Overestimating the market power premium means underestimating the efficiency premium.

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premium. The willingness of the acquirer to buy a company that is headed toward failure justifies giving its efficiency claims some additional credence.\footnote{31} The US Supreme Court interpretation of the alternative buyer condition was presented in the case of \textit{Citizen Publishing Co. v. United States}.

Failing company claims indicate a trade-off between two scenarios that need to be considered, the company exiting the market and an anticompetitive merger. The first scenario is of a great importance if the costs of the merger are balanced against the costs of blocking this merger, where there is a probability that the failing firm will survive and remain competitive. If blocking the merger implies that the failing firm’s assets will exit the market and therefore the output of this firm will be lost, the allowance of the merger seems to be the only sensible solution. The loss to stockholders, and community where the business operates would be less severe if the merger was allowed rather than if the firm exited the market.

Looking from an economic perspective, the capacity is a good predictor of output and lost output is a good measure of the competitive harm. In the case of a merger increasing concentration, it is very unlikely that the output will be reduced through the interdependence. More output is reduced if the acquired firm’s assets exit the market thus the merger is the preferred possibility.\footnote{32}


\footnote{32} A number of authors have estimated the loss in output from a firm exiting the market with the loss in output stemming from increased concentration. This literature points toward the conclusion that a certain loss in output by virtue of a firm’s assets leaving the market will exceed the loss in output from a merger under any realistic set of assumptions. See Kwoka & Warren-Boulton, ‘Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis’, 31 \textit{Antitrust Bull.} 431, 445 (1986), Friedman, ‘Untangling the Failing Company Defence’, 64 \textit{Tex. L.Rev.}
However, it should be noted that the current market share of the failing firm may overstate its future competitive significance and the anticompetitive effects of a merger. What would be of importance is whether the merged entity can unilaterally or collectively affect prices and output.

The failing firm defence might also be applied when only a part of the company is failing. Refusal of such defence would force the parent company either to end a subsidiary or to keep it going at a loss. This requirement was widely discussed by the US Supreme Court in the case of *International Shoe Co. v. Federal Trade Commission*.

The *General Dynamics* case provided the definition of the ‘flailing,’ ‘quasi-failing,’ or ‘weak competitor’ defence which was first applied by the lower courts in *U.S. v. International Harvester Co.*. The Court held that the acquisition did not violate Section 7 because the acquired company did not have sufficient financial resources to compete effectively. The claim that the firm to be acquired is a weak competitor is made in order to show that the merger is less troubling than the combined market shares. A ‘weak competitor claim’ can be made in the circumstances that are difficult to evaluate. In the case of *United States v. International Harvester Co.* the acquired company’s ‘weak competitor claim’ arose from its difficulty in borrowing the capital. The court allowed the acquisition because the acquired company lacked financial resources necessary to operate competitively. Nevertheless, a ‘weak competitor claim’ does not circumvent the requirement of the alternative purchaser. In *FTC v. Warner*

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33 *United States v. International Harvester Co.*, 564 F.2d 769 (7th Cir. 1977).
Communications Inc.\textsuperscript{34} the Court noted that a weak company defence would expand the strict limits of the failing company doctrine.

The spirit of the General Dynamics decision has been incorporated into the US Guidelines by language acknowledging that “recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm’s competitive significance” and committing to take into consideration “reasonably predictable effects of recent or ongoing changes in market conditions in interpreting market concentration and market share data.”\textsuperscript{35}

In United States v. General Dynamics Corp., although the US Supreme Court rejected a distressed industry defence, it emphasized the importance of considering all relevant facts, especially in cases where the relevant market or industry exhibits fluctuations as well as dynamic features.\textsuperscript{36} Antitrust authorities could also consider industry conditions as an argument in favour of approving a transaction. However, distressed industry conditions could lead to increased entry barriers and, therefore, make it more difficult for a transaction to obtain approval. In spite of that, antitrust authorities take into account the impact of economic conditions on the ability of firms to raise capital and make investments, which are needed to be more effective competitors. Antitrust


authorities should not obstruct efforts by failing or flailing firms to reorganize in order to become more efficient.

The presence of distressed industry conditions could also affect the speed of the investigation as a prolonged merger review may harm the firm to be acquired and could weaken it to a point that the merger no longer makes sense to the purchaser. The US Supreme Court rejected the failing industry defence in *Socony-Vacuum*. However, the US Department of Justice (DOJ) in *United States v. LTV Corp.* considered the weakened state of the companies. The LTV Corporation and Republic Steel Corporation announced plans for a merger in September of 1983 whereby LTV would acquire all the assets of Republic. The DOJ initially challenged the transaction, but agreed to settle the case, purportedly due to the weakened state of the companies and the efficiencies that would result from the transaction. Thus, in this case, the US authorities accepted the ailing industry defence.

Accepting the distressed industry arguments could help revitalize failing industries by lowering their overall costs and enabling them to compete more efficiently. In moderately concentrated

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industries exhibiting excess capacity, the ease of entry in combination with the increased threat of import competition would render any anticompetitive impact of the merger unlikely. However, difficulty in the identification of a distressed industry and the distinction between a distressed industry and an industry experiencing a downturn may constitute putting crucial weight on the consideration of the distressed industry circumstances unlikely. In the distressed industry defence there is a consensus that mergers are strong candidates to achieve efficiencies.\textsuperscript{41} Efficiencies which may not be credible in booming industries may be applicable when the distressed industry defence is invoked.

Deciding when and how to apply the defence is difficult in part because the facts underlying the failing company claim may be closely intertwined with other claims, which are analytically distinct. For example it may seem that current policy benefits alternative purchasers that are unlikely to offer the same efficiencies that a competitor purchaser may offer. In addition, the failing firm defence can be assumed to constitute an efficiency claim, since the acquiring company argues that it can ensure the viability and profitability of the failing company. As Correia argues, a failing company claim may also occur in the context of a declining industry where capacity is certain to exit the market. If that is the case, a merger may be justified both on efficiency grounds as well as on failing firm defence grounds, which must be analyzed separately. In general, only if the merger risks substantial harm to competition must the failing firm defence be assessed.\textsuperscript{42}


\textsuperscript{42} E. Correia. ‘The Failing Company Defence’, \url{www.ftc.gov/opp/global/final.htm}. 

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The assessment of a merger involving a failing firm should not be assessed in the same way as a merger which does not involve failing firms. Where a merging firm is failing pre-merger competitive conditions should not be used as a benchmark. If the competition authorities reject one or more mergers falling below an unsustainable benchmark, the result could well be liquidation which is expected to produce greater harm to competition than is predicted to result from one or more of the rejected mergers. If one of the parties to a merger is failing, pre-merger conditions of competition might not prevail even if the merger were prohibited. In such cases, the counterfactual might need to be adjusted to reflect the likely failure of one of the parties and the resulting loss of rivalry.43

One of the criteria of the failing firm defence, the lack of an alternative purchaser, must be established by good faith efforts to find another purchaser. It is required that the failing firm has made a good faith effort to obtain offers from other firms that would keep the failing firm in the market while making a less serious threat to competition. Thus, the failing firm must explore the alternative merger possibilities and seek out the *bona fide* offers. Current policy towards failing firm defence may prefer systematically alternative purchasers that are unlikely to offer the same efficiencies that a competitor purchaser may offer. In addition, the defence may induce companies to be in a severe state of decline before they qualify for the defence.

The requirement to make a good faith effort to find an alternative purchaser safeguards against a loss in competition. However, the alternative purchaser may have much less to offer in the way

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of improving the efficiency of the acquired firm than the prospective competitor-purchaser. In addition, there is concern that the competitor’s offer is higher because it includes a market power premium, a payment for anticipated gains in market power. There could be a market power premium, or an efficiency premium or both. The problem is that it is difficult to separate them. Overestimating the market power premium means underestimating the efficiency premium. The willingness of the acquirer to buy a company that is headed toward failure justifies giving its efficiency claims some additional credence.4445

44 E. Correia ‘The Failing Company Defence’, www.ftc.gov/opp/global/final.htm. The satisfaction of the failing firm defence criteria is biased in favour of non-market participants. Any efficiencies that a potential competitor-purchaser might generate from the merger may be unnecessarily sacrificed. Furthermore, a non-market participant may simply seek a revenue stream rather than seek to operate as an effective competitor by making long term investment plans. Many firms that purchase a distressed business may intend to ensure a revenue stream and not compete vigorously. In situations of severe financial crises and of lack of available capital, the identification of alternative purchasers may be very difficult as the lack of capital will create an insurmountable barrier to entry in the market. Valentine D. ‘Horizontal Issues: What’s Happening and What’s on the Horizon’. www.ftc.gov/speeches/other/dvhorizontalissues.htm.

45 Fingleton argues that crises induce long term benefits by facilitating the exit of inefficient firms from the market while facilitating the entry of new and better competitors. Considerations of entry have always been essential in competition enforcement. Assumptions of prompt entry into some markets may have to be revisited throughout the duration of the credit crisis. In situations where prompt entry is a condition for post-merger competition, or in conglomerate mergers where rivals’ access to capital is an important consideration in analyzing the danger of cross-subsidization, the likelihood of entry may be highly relevant to the decision. Although entry may not be likely or is indeed limited during the crisis, competition authorities need to assess the likelihood of entry once the crisis is over. Competition authorities may wish to mitigate the adverse effects of an anticompetitive domestic merger by preferring international takeovers of domestic firms where domestic mergers risk increasing market power. If the sustainability of a domestic firm needs to be maintained through its acquisition, then competition authorities and the
A lenient approach towards mergers involving failing and financially distressed firms can balance the losses from increasing concentration post merger with the gains from hastening entry and competition. The assessment of the failing firm defence in merger cases should take into account the effect of the policy rule on the incentives for entry (and ex ante investment decisions in general). According to research conducted by Mason and Weeds, the policy towards failing firms that competition authorities may adopt affects entry decisions.

Governments can promote new entry that can reduce competitive concerns of such mergers by reducing regulatory barriers to entry, increasing the availability of information available to consumers and ensuring that switching costs are limited. A firm’s willingness to enter a market may decline where profits within that market have become less attractive, as a result of a decline in customer demand. The ability of firms to enter certain markets may also be more limited under more restricted wholesale funding, particularly where potential entrants who may previously have been able and willing to enter on leveraged business models can no longer do so. Thus, purchasers may not be able to raise the necessary funds for the acquisition of the firm. Thus, competition authorities should not expect a long list of alternative purchasers and should be ready to accept a less anticompetitive purchaser in conditions of severe liquidity shortage. See also Devlin A. Antitrust in an Era of Market Failure, http://ssrn.com/abstract=1429539.


A firm entering a market also considers its ease of exit, foreseeing that it may later wish to leave should market conditions deteriorate. A way of entering in a market is the acquisition/merger with an incumbent. Such a merger/acquisition will allow the entrant to benefit from the infrastructure, expertise and customer base of the incumbent in the market. In addition, by facilitating exit in times of financial distress, the failing firm defence can encourage entry so as to increase overall welfare. Even if welfare is decreased when the firm enters the market by merging with or acquiring an incumbent, the increase in welfare resulting from earlier entry may more than offset this loss.
Apart from the importance and implications of entry in a merger involving a failing firm, competition authorities should also pay attention to potential dynamic or innovative efficiencies in assessing such a merger. Dynamic or innovative efficiencies may make a particularly powerful contribution to competitive dynamics, R&D, and welfare but are not readily verifiable and quantifiable because they tend to focus on future products. Merger analysis should give efficiencies more weight if the profitability of a failing industry can be improved by the merger (e.g., by lowering fixed costs) even if the price effects are not immediate. Thus, there is a trade off between the viability of the failing firm and the positive impact that it may have on competition due to the existence of one additional competitor in the market on one hand and the further consolidation in the market (if a competitor merges with/acquires the failing firm) due to the merger, which may also result though from the exit of the failing firm from the market, on the other.

As we have seen, in the application of the failing firm defence, one of the criteria is also that the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Furthermore, in the absence of a merger the assets of the failing firm would inevitably exit the market. Thus, for the failing firm defence to apply, a merger/acquisition and/or sale should be the only viable method of corporate restructuring. Otherwise, the failing firm defence cannot be applicable. A tentative conclusion can be made that lack of alternative means of reorganisation is a vital criterion for the success of the failing firm defence. However, there is substantial uncertainty surrounding the reorganization scenario. A significant problem in applying the reorganization criterion, especially in crisis
periods, is that it may be impossible to make reliable predictions at the time of assessing the merger as regards the likelihood that alternative restructuring methods will be successful. Thus, competition authorities should be careful in confirming the availability and likelihood of alternative reorganisation scenarios.

According to Correia, competition authorities should take also social costs into account in adopting some general formulation of the failing company defence, rather than take social costs into account in individual cases.49 Such concerns may lead to a different interpretation of consumer welfare, entitling thus competition authorities to take social, public policy as well as employment issues into consideration in defining their consumer welfare objective of merger assessment. With the Lisbon Treaty coming into force on 1 December 2009, interpretative issues could also arise due to the stronger references to full employment and social objectives, including the reference to a highly competitive social market economy, in amended Article 3 of the Treaty on European Union. This might induce arguments that a broader industrial policy standard should apply.50


The policy towards mergers may have an impact on the employees of the merging firms. Allowing mergers can result in job losses as may also be the case in prohibiting mergers. If a merger is not allowed and the failing firm exits the market, the lost jobs originate from plants closure. When the failing firm disappears from the market, the employment resources of this firm are likely to be devoted to the manufacture of a completely different product or provide totally different services, perhaps not as efficiently.
There are advocates who argue that the likelihood of job losses, inefficient use of labour force and the political/social ramifications that such issues may have should not determine the assessment of mergers under antitrust law. Issues relating to employment safety should be dealt with by employment policy and should not influence antitrust policy. However, according to Posner\textsuperscript{51} the failing firm defence is \textit{one of the clearest examples in antitrust law of a desire to subordinate competition to other values}.\textsuperscript{52} The social policy consideration regarding the merger works alongside the impact of the merger on competition.\textsuperscript{53}

As the case law analysis indicates, arguments such as that the target company will exit the market if it becomes independent, that jobs will be lost will not constitute reasons for clearance of the concentration. However, as Ritter \textit{et. al} argued, revitalization of the target company to operate more efficiently may constitute a reason for the concentration to be cleared.\textsuperscript{54}

\textsuperscript{51} Richard Posner was an assistant to the Federal Trade Commission, assistant to the solicitor general of the United States, in 1981 appointed as a judge of the U.S. Court of Appeals for the Seventh Circuit. He was the chief judge of the court from 1993 to 2000.


\textsuperscript{53} In addition to economic and social concerns, the relevant public policy considerations are related to the protection of private parties whose future depends on the existence of the failing firm as well as the welfare of the locality of the failing firm. The shareholders are unlikely to lose the investment and are likely to reap benefits in case the merger is 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.

Considering the likely anti-competitive outcome of allowing a merger involving a failing firm and the counterfactual of blocking the merger and the firm exiting the market, an argument can be made in favour of a more lenient policy towards the failing firm defence which could be characterised as permitting the defence to be used by severely distressed as well as by imminently failing firms and may yield social benefits through its beneficial impact on entry, resulting in more effective competition in the long run. Thus, competition authorities might consider being less restrictive not only to mergers involving failing firms, but also to mergers involving divisions of failing firms, as well as failing divisions of firms. However, some assurance may be needed that the division’s failing status is not merely a reflection of creative accounting as regards issues like transfer payments and the allocation of common costs.\(^\text{55}\) With a more lenient approach to failing divisions, the outcome of the Bertelsmann,\(^\text{56}\) and Rewe/Meinl\(^\text{57}\) mergers might have been different. The Commission took a more lenient approach towards a failing division in the News Corp/Telepiù\(^\text{58}\) merger where it considered the overall conditions of the Italian market in clearing the merger.

Summing up the above analysis, saving unproductive companies harms long-term growth since if a business goes bankrupt, its competitors pick up its market share and the sector continues to

\(^{55}\) In certain cases, competition authorities should place great caution to flailing firm defence arguments. If under-performing, inefficient and poorly managed firms are bailed out simply because of the crisis and the fact that they are large employers, then the message to industry will be simply to become too big to fail and not to be concerned about being efficient.

\(^{56}\) Case No IV/M.993 - Bertelsmann/Kirch/Premiere [1999] OJ L 053/1.

\(^{57}\) Case No IV M.1221 Rewe/Meinl, [1999] OJ L 274/1.

\(^{58}\) Case COMP/M.2876 - News Corp/Telepiù, [2004], OJ L110/73.
function. In some cases new firms may enter and create new jobs over a short duration, contributing to positive employment effects. However, the potential for job losses may lead to pressure on governments to adopt measures against the closure of the flailing firm. Collins, the Chairman of the OFT, argues that governments were under wider pressure to preserve jobs, to retain skills, manufacturing bases and supply chains, and to intervene more in markets such as automotives.\textsuperscript{59} As the OECD states in its Report,\textsuperscript{60} \textit{governments need to make a case-by-case call on whether and how to provide some kind of assistance, depending on an analysis of the systemic, economy-wide implications of failure in a particular industry.}

In a speech concerning the financial crisis, Neelie Kroes\textsuperscript{61}, European Commissioner for competition policy said the following:

\begin{quote}
\textit{The Commission is committed to continue applying the existing rules, taking full account of economic environment.}

\textit{That means the Commission can and will take into account the evolving market conditions and, where applicable, the failing firm defence.}
\end{quote}


\textsuperscript{61} Neelie Kroes, European Commissioner for European Policy, \textit{Dealing with the Current Financial Crisis}. www.europa.eu.
• The existing rules allow the Commission to permit take-overs to be implemented without having to wait for the Commission's approval in cases where there is urgency and where there are no 'a priori' competition concerns.

• The Commission can indeed grant derogations from the standstill obligation, pending a definitive outcome of the proceedings, so as to enable the immediate implementation of the transactions which are part of rescue operations.

As we have demonstrated above, it is a difficult task for the parties to prove that one of the firms is failing (in the sense of the failing firm defence) by demonstrating that all the requirements are met. In times of crisis, the emergency created by the financial distress requires fast and effective measures. Authorities must be able to act effectively and in the shortest time period possible. Therefore, competition rules must be flexible and a case by case application must be acceptable when the considerations at hand are more important than the blind application of the texts. In other words, the violation of the regulations or at least their application with more flexibility than usual constitutes less damage than the one caused by their strict application. The Commission, after the meeting held in Brussels on 29 October 2008, through the speech of its President, made it clear that flexibility is inevitable when the situation is of certain gravity. We should note that in declining industry situations it is more likely that firms flailing today will be failing tomorrow. Flexibility implies that a court accepts the defence despite the fact that the alleged failing firm is not likely to exit the market in the near future but is in a financial distress that makes it difficult for it to exercise real and effective competition.

The European Commission seems to have outlined their priorities: antitrust laws are very important. However, in times of crisis, they must be applied with flexibility and interpreted largely to leave room for more effective measures intended to maintain financial stability and rescue different entities such as banks and financial institutions. Fingleton\textsuperscript{63} has argued that the fact that banks are different from other businesses may exceptionally justify intervention. However, Lowe has argued, that it is necessary to recognise the systemic and special features of the banking sector, the reality that the banking sector is no different from any other sector in terms of the need to restructure, and to plan out what constitutes a return to viability.\textsuperscript{64,65}

\textsuperscript{63} J. Fingleton \textit{Competition policy in troubled times} 20 January 2009, \url{www.oft.gov.uk}.


\textsuperscript{65} Carletti, a consultant to the OECD in a similar vein argued that it was not clear whether a distinction could be made between the financial sector and the real sector in considering how to apply antitrust policy in a systemic crisis. Bank failure risks systemic effects (i.e. the failure of one bank may lead to a run on others, as opposed to other sectors where the removal of one player can induce benefits for its competitors). As the OECD argues, the loss of confidence in one major financial institution in a financial crisis can snowball into a loss of confidence in the entire market because the inability of one bank to meet its obligations can drive other, otherwise healthy, banks into insolvency. The collapse of confidence in turn caused liquidity to disappear, and thus removed an essential element for the banking system to function almost inducing a systemic collapse. In this sense, the credit crunch resulted from an exceptional implosion of supply, and not simply a cost increase or a contraction of demand. \textit{Summary Record of the discussion on Competition and Financial Markets}, DAF/COMP/M(2009)1/ANN2, 10 April 2009, \textit{Introduction and Roundtable 1 on Principles: Financial Sector Conditions and Competition Policy}, \url{www.oecd.org}. See also \textit{Competition and Financial Markets}, OECD Report, 2009.
Professor Ito in his submission to the OECD said that he questioned the perceived view that a merger was necessarily bad for competition simply because it reduced competition.\(^{66}\) He questioned how many firms could exist in any one industry in any one country, and considered that more was not necessarily better, even given scale economies. The Japanese recovery from the problems of the 1990s was very protracted because there were too many small construction companies in the industry. Mergers should have been one of the answers (the other being bankruptcies, according to the author) because there were too many inefficient companies in the industry. He adds that the financial industry was a special case but the auto industry was no more special than the electronics or airline industry. Following from this argument, we should note that if there were too many companies in one industry and more firms than the optimal number then mergers should be allowed, especially if imports were liberalised at the same time. Thus, in such industries, especially in periods of crisis, failing firm defence arguments should be viewed with an even more positive attitude not only in order to sustain the viability of some of the incumbents but also in order to reduce the number of the sustainable firms in an industry.

A more lenient approach in regards to mergers involving the failing firm defence on part of the competition authorities in Europe might play a crucial role in recovering from the crisis. But while this approach might be helpful for the companies to overcome their difficulties it might have adverse effects for future and long term competition. The unstable economic climate might

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\(^{66}\) *Summary Record of the discussion on Competition and Financial Markets, DAF/COMP/M(2009)1/ANN4, 10 April 2009, Roundtable 3 on Real Economy and Competition Policy in a Period of Retrenchment, [www.oecd.org](http://www.oecd.org).*
constitute a window of opportunity for pursuing more difficult deals ‘since the downturn is likely to have produced more fertile ground for ‘failing firm’ arguments’.67

In the presence of a severe crisis, e.g. a financial crisis affecting a whole economy and bearing the risk of systemic crisis, the different markets and the financial stability and welfare of consumers, employees and competitors are all affected. If the credit market has ceased to function effectively, then firms struggle to obtain financing. Banks or other providers of finance normally play a crucial role in sorting out the efficient from inefficient players. Hence, competition rules fail to achieve their original goal in the presence of a stronger and more urgent priority called crisis. Consequently, it is completely understandable to substitute, for a short time only and until the crisis is ended, competition rules by exceptional rules, decided by the competition authorities/courts on a case by case basis, in order to provide a solution that benefits the economy in general including consumers, shareholders (of the failing firms) and employees (even though social issues are usually intentionally neglected in antitrust law).

Deciding when and how to apply the defence is difficult in part because the facts underlying the failing company claim may be closely intertwined with other claims, which are analytically distinct. A merger that would be blocked due to its adverse effect on competition is permitted when the firm to be acquired is a failing firm and a less detrimental merger is unavailable. Blocking the merger will cause the loss of jobs and assets from the market and thus possible

economic and social benefits will be foregone. Therefore, a merger with a failing firm leading to high concentration may be accepted under the failing firm defence. In the assessment of a merger involving a failing firm defence, competition authorities should take into account the conditions in the industry, potential efficiencies and the counterfactual to blocking the merger.

In sum, considering the merger with the failing firm during a crisis, the economic aspects of allowing and blocking this merger, such as the loss of jobs, benefit to consumers, price maintenance, should also be born in mind. Social costs must be taken into account in adopting some general formulation of the failing company defence, rather than taking social costs into account in individual cases. Thus, in the assessment of a merger, the overall conditions of the market should be taken into account, as well as the social and economic implications of allowing or blocking the merger. However, the likely anticompetitive effects of the merger should be one of the leading influencing factor in assessing the transaction, rather than other social and public policy considerations.

Furthermore, if the merger/acquisition of a failing firm is not allowed and the failing firm exits the market any technical or productive achievements of the failing firm will be lost. Hence, there may be adverse welfare implications. However, exit of the failing firm may be preferable from a competition perspective since the remaining firms may compete more aggressively to counteract the decrease in supply due to the loss of the failing firm’s capacity and in order to win the failing firm’s customers.

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The failing firm defence carries most weight when it can be shown that the merger enables productive assets to continue in productive use. The exit of the failing firm will lead to an increase in demand and an ensuing increase in production costs and prices (unless the firm is the least competitive in a declining market). If the failing firm merges/is acquired by a dominant firm, the latter will obtain assets and know-how that allow an increase in productivity, enhancing thus its competitive position. Hence, such a merger/acquisition may lead to lower production costs and prices.

The next few years seem likely to see consolidation mergers in many sectors, for example, the talk of consolidation in the US automotive industry. As Correia has argued, a failing company claim may also occur in the context of a declining industry where capacity is certain to exit the market. If that is the case, a merger may be justified both on efficiency grounds as well as on failing firm defence grounds, which though must be analyzed separately. As mentioned above, in many cases, regulators will be faced with a case that presents challenging competition issues, but a strong commercial imperative to get the deal done quickly.\(^{69}\) It should be noted, that in the assessment of the failing firm defence, the overall conditions of the market should be taken into account, as well as the social and economic implications of allowing or blocking the merger. Antitrust policy and the likely anticompetitive effects of the merger should be one of the leading influencing factor in assessing the transaction.

In general, the financial crisis does not entail that there should be a change in the fundamentals of antitrust law as regards the application of the failing firm defence since drastic and excessive

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changes would be dangerous for the structure of the economy. The OECD Report states that international cooperation in setting and enforcing antitrust policy, especially in relation to failing firm defence claims, is essential for ensuring consistency in troubled times, speeding up the enforcement process and giving clarity to enforcement activities.

Although competition authorities will be asked to clear an anticompetitive deal it is not realistic to expect that competition authorities would necessarily have a place at the table discussing sensitive issues that arise amidst crises. Of course it would be preferable to be at the table when issues are discussed across governments. BIAC in its presentation to the OECD argued that competition authorities should do all they can to ensure that they are called to the table, that they accept the invitation and ensure that their analytical presentations are carried out within the necessary time frame, and with the degree of flexibility that the situation warrants. Thus, BIAC in addition to the full fledged competition analysis, it stresses the necessary flexibility that competition authorities should have in tackling issues that arise during a crisis.

According to the OECD Report, the principles and objectives of antitrust law enforcement therefore must not change, but the analysis has to be realistic about the conditions in the market. That means continuing the shift from a form-based analysis to a case-by-case analysis in which the context and effects of actual practices and behavior are very much taken into consideration. The Commission can use its margin of discretion flexibly in the assessment of the failing firm

defence to take account of present market conditions. The failing firm defence’ difficult conditions are justified under normal circumstances. In fact, it would be too easy for firms to fake financial distress in order to succeed a merger that would have been otherwise blocked unless the evidential burden is substantial. However, in crisis situations, competition authorities and courts in the EU must take into considerations the grounds on which the failing firm defence was introduced in merger legislations and apply it temporarily with more flexibility in order to achieve those same original goals. We should emphasize that any flexibility shown by the European Commission and the competition authorities in the EU during the credit crunch must be considered as exceptional and temporary.
CRISIS CARTELS AMIDST CRISES

Cartels generally involve conducts such as price fixing, market division, control of output, mitigation of technological improvement, limiting of production. Through cartels ‘private’ interests may determine the level and distribution of the national income, the level of employment, the stability of the markets, as well as in general economic and political stability. Cartel justifications that have been proposed include that a cartel will prevent cutthroat 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 e.g., 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.

Arguments for ordered restructuring of industries or firms colluding on the removal of spare capacity are typical of the forms of cartelization that are likely to be seen in a recession. Many collusive agreements have been formed amidst adverse market conditions. In addition, the conduct of executives may change in situations of crisis, inducing them to put their job safety over any concerns they may have with price fixing. Without industry wide agreements on capacity reduction that can be achieved through a crisis cartel, smaller firms may exit the market leaving thus 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 be incurring losses. However, the possibility of criminal sanctions, in some jurisdictions, may dissuade such
executives from being engaged in cartelistic behaviour. In addition, the possibility of demand increasing in the future increases incentives to deviate from the cartelistic conduct.

In periods of crises in economies, without the industry wide agreement on capacity reduction that can be achieved through a crisis cartel, smaller firms may exit the market leaving thus a limited number of choices for customers as well as inducing unemployment. In such conditions, firms may operate at inefficient output levels and may even be incurring losses. The Commission has defined structural overcapacity as existing ‘where over a prolonged period all the undertakings concerned have been experiencing a significant reduction in their rates of capacity utilisation, a drop in output accompanied by substantial operating losses and where the information available does not indicate that any lasting improvement can be expected in this situation in the medium term.’

Difficult economic times often lead to increased temptations for competitors to reach anticompetitive agreements that will allow them to sustain their viability. Thus, an increase in cartel enforcement is likely to occur. Crisis conditions may make it more difficult for antitrust authorities to obtain the amount of fines that will ensure deterrence. Such difficulties that are due to the crisis conditions, could lead competition authorities to look for other methods of deterrence, such as jail sentences or other sanctions for individuals.

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Philip Lowe, at the OECD Roundtable, argued that on cartels, the more that coordination of output or price by the producers themselves was allowed, the more likely it was that crisis measures aimed at reducing capacity would be accompanied by collusion, detrimental to everyone, to competitiveness and to consumers and taxpayers. We should emphasize that as the EU experience has shown such agreements should not be applied on specific firms but on the majority of firms or on industries as a whole. As the EC has indicated agreements to reduce structural overcapacity which involve all or a majority of the undertakings in an entire sector, can be accepted if they are aimed solely at a coordinated reduction of overcapacity and do not restrict the commercial freedom of the parties involved.

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74 See further the paper herein that addresses crisis cartels in detail.

75 Agreements involving a smaller number of firms can also be accepted if they aim at allowing reciprocal specialisation in order to achieve closure of excess capacity. See further: 13th Report on Competition Policy, paragraph 56.

76 An additional indication of the political involvement in competition enforcement is illustrated by the promotion of price agreements by the argentine government in response to heightened concerns of inflation. Argentina had shown robust growth rates but the government was concerned about the negative effect of high inflation. The government concluded price agreements with supermarkets, dairy and meat producers in order to freeze the retail and wholesale prices for a given period of time. P.I. Colomo, ‘The Revival of Antitrust law in Argentina: Policy or Politics?’ (2006) E.C.L.R., 27(6), 317-323. As regards crisis cartels the Commission has in the 7th Report on Competition Policy announced that measures to open competition were necessary in circumstances of adverse social and regional circumstances. In the 8th Report on Competition Policy the Commission argued that it is inclined to accept that under certain conditions agreements between firms aimed at reducing excess capacity may be authorised under Article 85(3) but only where the firms have not simultaneously whether by agreement or concerted practice fixed either prices or production or delivery quotas.
The Commission has stated that structural overcapacity occurs when over a long period, undertakings are experiencing a reduction in their capacity utilisation, a drop in output as well as operating loses, and there is no sign of possible recovery in the medium-term.\textsuperscript{77} As mentioned above, in the 23\textsuperscript{rd} Report on competition policy, the Commission argued that\textsuperscript{78} agreements to reduce structural overcapacity which involve all or a majority of the undertakings in an entire sector, can be accepted if they are aimed solely at a coordinated reduction of overcapacity and do not restrict the commercial freedom of the parties involved. Agreements involving a smaller number of firms can also be (and to some extent exceptionally) accepted if they aim at allowing reciprocal specialisation in order to achieve closure of excess capacity. However, the Commission argues that such agreements must not incorporate any price fixing, quota fixing or market allocation.\textsuperscript{79}

There have been a number of cases involving a restructuring plan to tackle excess capacity. In a case involving a restructuring plan to tackle the excess capacity in bricks in the Netherlands, an agreement notified to the Commission for exemption was initially not approved as it contained

\textsuperscript{77} 12\textsuperscript{th} Report on Competition Policy, paragraph 38.

\textsuperscript{78} See European Commission, 23\textsuperscript{rd} Report on Competition Policy, Point 84.

\textsuperscript{79} 13\textsuperscript{th} Report on Competition Policy, paragraph 56. In the OECD Report, BIAC has supported the continued use of conventional competition principles in periods of crises but importantly it added that there was no time for excessive regulation, which would impose extra costs on businesses in excessive fines and remedies. The EU added that the need for authorities to be realistic about the impact of remedies or fines on markets was right, and it was clear that full account needed to be taken of a firm’s ability to pay a fine, especially where imposition of a fine led to a lessening of competition.
several restrictions of competition including quota agreement. The agreement was exempted after the parties excluded any fixing of prices or output and on the grounds that the agreement was in line with the criteria outlined in the 23rd Report on competition policy.\textsuperscript{80}

In the \textit{Polypropylene} case,\textsuperscript{81} the Commission outlined its view on crisis cartels and argued that price and quota fixing is usually unacceptable.\textsuperscript{82} There have been a number of cases under the Treaty of Rome involving crisis cartels where in the majority of the cases the undertakings requested an exemption pursuant to Article 101(3). The Commission will authorize a restructuring plan involving sectoral agreements if it is believes 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 efficient capacity utilisation enhancing the competitiveness of the sector and thus benefiting consumers. Thus, a detailed plan of plant closures as well as avoidance of creation of new capacity are also necessary factors in the agreement being accepted by the Commission.

\textsuperscript{80} 23\textsuperscript{rd} Report on Competition Policy, point 89. IV/34.456 - Stichting Baksteen OJ L 131/15.

\textsuperscript{81} Re Polypropylene O.J. 1986 L230.

In 1984 the Commission accepted that joint measures aiming at the reduction of structural overcapacity or other restructuring measures in an industry which is in a state of crisis, may be accepted provided that effective competition is not eliminated, consumers have alternative choices of suppliers and does not involve conducts such as fixing prices or quotas. The Commission exempted an agreement of reduction in the production of synthetic textile. The Commission argued that the agreement fulfilled the Article 101(3) criteria as it contributed to the improvement of production and importantly, allowed the restructuring process to proceed in a socially acceptable way by making suitable arrangements for the retaining and redeployment of workers made redundant. Thus, the Commission in exempting the agreement took into account employment and social factors into account in exempting the agreement. Furthermore, the Commission argued that consumers would receive a fair share of the benefits as the restructuring will result in an industry able to offer better products at, according to the Commission, competitive terms. In order the Commission to satisfy itself that competition will continue to

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84 OJ L207/17, 2.8.1984. The ten largest European manufacturers reduced their production capacity by 18 per cent. In order to exempt the agreement, the parties undertook to supply a trustee with information on the planned capacity to be reduced as well as of the plants. In addition, compensation would be paid to the other participants to the agreement in case some parties did not fulfill the capacity reduction. The parties should consult each other in the case of important changes in the market and should not fail to implement the planned reductions in capacity. The Commission requested the deletion of some clauses of the original agreement. These clauses were related to a ban on investment leading to capacity increases without consent of all parties as well as to a requirement not to operate a plant at more than 95 per cent capacity. The Commission did not accept the latter clause as it would have allowed the parties to monitor output and deliveries.

85 14th Report on Competition Policy.
exist in spite of this agreement reducing capacity, it took into account that the agreement is of limited duration, as well as the fact that there are substitute products from other competitors outside the agreement or the involved countries.

Bilateral agreements have also been used to mitigate problems of structural overcapacity. Such agreements have been a particular feature of the petro-chemical sector in recent years. The effect of these arrangements is to enable petrochemical companies to specialise in products where they have a comparative advantage. Such agreements will have adverse effects on competition. Such a bilateral agreement was the agreement to reduce capacity in *BPCL/ICI*\(^{86}\) involving two British manufacturers in the petrochemical sector, which was exempted. The agreement was exempted pursuant to Article 101(3). The sector was characterised by excess capacity and as a result of the agreement the two firms would be able to reduce the costs of production. Thus, the agreement was expected to contribute to the efficiency of production. Similar to the previous cases where the Commission has granted an exemption, the Commission added that even after the elimination of one producer consumers would still have choices of supplier.

The reduction in capacity can in the long-run increase profitability, restore competitiveness as well as mitigate the adverse impact on competitiveness.\(^{87}\) The agreement must contain a detailed and binding programme of closures for each production centre in order to ensure reduction of existing capacity and to prevent the creation of new capacity. The incorporated restrictions of


\(^{87}\) The Commission seems to place importance on non-competition factors such as employment. The Commission clearly states that *reorganization operations should be such as to secure the employment situation within the sector concerned*. 12\(^{th}\) *Report on Competition Policy*, paragraph 39.
competition must be indispensable in order to achieve the restructuring of the sector. The agreement must be of certain duration that will allow for the technical implementation of the capacity reduction. Consumers must enjoy a share of the benefits resulting from the agreement, since in the longer run they will benefit from a competitive environment while in the short-run they will have not been deprived of choices of products.

Thus, in a nutshell, the conditions that need to be fulfilled before an exemption is granted (i.e. the Article 101(3) criteria are satisfied) include improvement of production and distribution, indispensability of the restrictions, not a complete elimination of competition, a fair share of the benefits to consumers, and finally the benefits must outweigh the disadvantages.

The agreement aiming at the coordinated reduction in capacity will not be likely to restrict competition since the parties to the agreement will independently decide their strategies on elements other than the coordinated reduction in capacity. There may be other firms in the market not parties to the agreement, which may be able to provide competitive constraints. 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 the agreement as well as the fact that the coordinated reduction in capacity is only one element in the business strategy of firms constitute reassurances that competition will not be eliminated.

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88 As the Commission states in the 12th Report on Competition Policy, (paragraph 39) exchange of information is acceptable provided it does not induce coordination either on sale conditions or on the remaining capacity.
The Commission has faced difficulties in exempting crisis cartels pursuant to the Article 101(3) criteria. Thus, the Commission has sometimes relied on the maintenance of employment in order to exempt such agreements. The Commission explicitly states that *reorganisation operations should also be used to stabilize and secure the employment situation in the sector concerned.*

The Commission uses the positive impact of a coordination of business conduct of competitors on employment as a factor favouring exemption of the agreement. The ECJ in the Metro case argued that a medium term supply agreement was deemed to satisfy the first condition of Article 101(3) since it was considered likely to help maintain employment in situations of economic crisis.

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89 23rd Report on Competition Policy, point 88.


91 Case 14/68 *Walt Wilhelm v. Bundeskartellamt* [1969] E.C.R. 1 Motif 11. As Hornsby (1987) argues, this passage is increasingly used to provide a legal base for the Commission’s use of the competition rules to achieve other policy objectives. See further: Hornsby (1987) ‘Competition policy in the 80’s: more policy less competition?’ E.L. Rev. 1987, 12(2), 79-101. Similarly the ECJ in *Walt Wilhelm* held that ‘while the Treaty’s primary object is to eliminate by this means (proceedings under Article 85(1)) the obstacles to the free movement of goods within the Common Market and to confirm and safeguard the unity of that market, it also commits the Community authorities to carry out certain positive, though indirect, action with a view to promoting a harmonious development of economic activities within the whole community in accordance with Article 2 of the Treaty.’

92 Hornsby (1987) adds that decisions explicitly justifying crisis cartels by reference to distortions caused by state aids could be legally justified in appropriate cases by reference to the preliminary provisions of the Treaty as indicated by the European Court in *Walt Wilhelm.* Not only has the Commission and the European Court used such a legal technique before (See Case 6/72 *Europembaliage and Continental Can v. Commission* [1973] E.C.R. 215. Cases 6 and 7/73 *Commercial Solvents v. Commission* [1974] E.C.R. 223 motif 25), but also emphasis on the more economic criteria set out in the preliminary Articles would be more consistent with Article 85(3) [or 101(3) pursuant to the Lisbon Treaty] than references to employment considerations which are not referred to at all in the rules.
According to ECJ, when deciding whether an agreement will be caught by Article 101(1), it is not necessary to further consider its actual effect if it seems to have its object to prevent, restrict or distort competition within the common market.\(^93\) Close attention must be paid to the wording and the objective of an agreement when determining whether it falls within the prohibition of Article 101(1).\(^94\) Even if it can be established that the parties have no ‘subjective intention to restrict competition, but with an object to remedy the effects of a crisis in the industry’, it is irrelevant for the purposes of applying Article 101(1). It may only be taken into account when considering whether an exemption under Article 101(3) could be granted.\(^95\)

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\(^93\) Case C-209/07 The Competition Authority v The Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd 2008, ECR 00, paragraph 16.

\(^94\) Case C-209/07 The Competition Authority v The Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd 2008, ECR 00 at paragraph 21. The ECJ has eloquently stated that in fact, to determine whether an agreement comes within the prohibition laid down in Article 101(1), close regard must be paid to the wording of its provisions and to the objectives which it is intended to attain. In that regard, even supposing it to be established that the parties to an agreement acted without any subjective intention of restricting competition, but with the object of remedying the effects of a crisis in their sector, such considerations are irrelevant for the purposes of applying that provision. Indeed, an agreement may be regarded as having a restrictive object even if it does not have the restriction of competition as its sole aim but also pursues other legitimate objectives (General Motors v Commission, paragraph 64 and the case-law cited). It is only in connection with Article 101(3) EC that matters such as those relied upon by BIDS may, if appropriate, be taken into consideration for the purposes of obtaining an exemption from the prohibition laid down in Article 101(1).

\(^95\) Case C-209/07 The Competition Authority v The Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd 2008, ECR 00 at paragraph 21.
The ECJ has argued in past decisions that the existence of a crisis in the market cannot in itself preclude the anti-competitive nature of an agreement. The existence of a crisis might have been relied upon in order to seek an exemption under Article 101(3).\textsuperscript{96} The ECJ, does not prohibit the existence of crisis cartels \textit{per se}, but argues that the legality of such cartels needs to be assessed pursuant to the exemption criteria of Article 101(3). This view confirms the practice, in relation to crisis cartels, that we have seen in the enforcement of Article 101 since the early 1960s.

There can be multiple types of agreement that companies may use to overcome capacity problems. Crisis cartels through bilateral or multilateral agreements can satisfy the conditions of Article 101(3). Bilateral agreements are a more likely form of rationalisation agreement (as achieving the coordinated reduction in capacity among two firms is easier than among a larger number of firms) but less likely to satisfy the conditions of Article 101(3). To satisfy the criteria of Article 101(3) such agreements should lead to a reduction in the excess capacity, rationalise production and not lead to elimination of competition.\textsuperscript{97}

Turning to the ‘financial constraints’ consideration, that has been advocated in several cases it reflects a concern that high fines might force an offending firm into insolvency. The EC and US have wide discretion as well as lack of transparency in awarding these discounts. However,


\textsuperscript{97} In addition, restrictions on imports imposed by intergovernmental voluntary restraint agreements may also lead to a reduction in the excess capacity of a sector. For further info on such agreements see: L. Ritter, D. Braun European Competition Law, 3\textsuperscript{rd} ed., (London: Kluwer, 2004), page 185.
factors external to antitrust policy, in particular the social objectives, may determine how they are granted. So firms can be involved in cartels and not ending up paying a fine in crisis situations, increasing thus their profits from collusion, and thus increasing their tendency to be in cartels (in the absence of criminal sanctions like the UK competition authorities can impose). The Commission has accepted such discounts in crisis industries, rather for individual firms in crisis. In the French beef\(^98\) case the Commission alleged that French federations in the beef sector were involved in a price fixing cartel. The Commission underlined that even those circumstances cannot entitle private parties to pursue anticompetitive conduct.\(^99\) However, the imposed fines were very low, as the Commission gave extensive credit for the exceptional economic context. The fines were reduced by 60 per cent, rather than the more usual 10-15 per cent that is the usual reduction in cases of sectors being in crisis.

The Commission has accepted such discounts in crisis industries, but in general not for firms in crisis. The availability of a financial constraint defence aiming at reducing the fines encourages the creation of cartels as actual levels of fines are reduced. When a cartelist knows that the fine will never be high enough to threaten its financial viability, there is an incentive for it to intensify the infringement as the fines are reduced due to the financial constraint defence.\(^100\)


\(^100\) According to the EC Guidance on fines, in exceptional cases, the Commission may, upon request, take account of the undertaking’s inability to pay in a specific social and economic context. It will not base any reduction granted for this reason in the fine on the mere finding of an adverse or loss-making financial situation. A reduction could be granted solely on the basis of objective evidence that imposition of the fine as provided for in these Guidelines would irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all
In crisis situations firms can be involved in cartels and may end up not paying a fine, increasing thus their profits from collusion, and thus increasing their tendency to be in cartels (in the absence of criminal sanctions). The US, \(^{101}\) UK, Ireland and Germany, for example, have criminal and civil penalties for corporate and/or individual violations of their antitrust laws, while the EC has a civil penalty only against the corporation. A compensation of the lack of deterrence due to the reduction in the fine, can be possible criminalisation. With criminalisation, the financial viability of the firm is not adversely affected, while at the same time deterrence is maintained, if not increased. The key significance of the criminal regime from an enforcement perspective lies in its deterrence value and, in particular, its separation of the interests of individuals from those of the businesses that employ them. A report prepared for the OFT by Deloitte \(^{102}\), in which antitrust lawyers and companies were asked about the relative importance of various factors in deterring antitrust law infringements. Both the lawyers and companies surveyed regarded criminal penalties as being the most important \(^{103}\).

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\(^{101}\) In the US, the DOJ has criminal sanctions, as well as treble damages in civil anti-trust actions, which can ‘compensate’ for any reduction in fines. As Stephan notes in the DOJ’s *Graphite Electrodes* case, two executives of UCAR were jailed for 17 months and 9 months respectively and a total of seven other executives were prosecuted and fined. UCAR received a reduction in its fine. However, cartel deterrence was enhanced by the imposition of the jail sentences. Stephan A. *The bankruptcy wildcard in cartel cases*. J.B.L. 2006, August, 511-536.


\(^{103}\) The deterrent effect of competition enforcement by the OFT, November 2007 (OFT962). [www.oft.gov.uk](http://www.oft.gov.uk), paragraphs 5.55 to 5.59.
Where cartel prohibitions are enforced with criminal sanctions on individuals, (including imprisonment), the standard of proof has to be particularly high (‘beyond any reasonable doubt’) and it is more difficult to discharge the burden of proof without the active help of cartel members, i.e. without admissions and without the agreement of the companies. These personal risks also have the effect of further destabilising cartels, making it more likely that, once entered into, they will not be sustained. When operating alongside an effective leniency policy that aligns the interests of individuals with those of their employers, together with other sources of intelligence, it also means that cartels are more likely to be detected and punished, thus reinforcing deterrence, especially in the presence of reduced fines that will ensure the viability of undertakings.

The imposition of fines that risk driving companies out of business is not acceptable to competition authorities for four main reasons. Stephan argues that anything that increases the risk of bankruptcy imposes a social cost which according to Posner, consists of the transfer of wealth away from shareholders, managers, employees and creditors, reductions in efficiency of asset use, cost to creditors who will not be paid, and the cost to other firms who relied on the bankrupt firm as a customer.

A high fine may induce severe liquidity problems to firms, some of which may go bankrupt. In such a case, the resulting increase in concentration in the renders collusion more likely. As the

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105 The cost of professional services such as lawyers and bankers that are related to the bankruptcy proceedings can run into hundreds of millions of dollars. See further: Stephan A. The bankruptcy wildcard in cartel cases. J.B.L. 2006, August, 511-536.
market becomes more concentrated firms may use this increased concentration in order to reap benefits from anticompetitive conducts. A high fine is likely to induce intensive political lobbying against its imposition. In addition, if firms go bankrupt parties injured by collusion will not be able to claim damages. A firm’s maximum fine for its infringement in Europe is 10 per cent of its annual turnover. Thus, when a market is experiencing a crisis firms in this market are likely to face liquidity problems and thus the fine will be calculated on a lower turnover and thus will be lower than it would be had the crisis not occurred. We should note though that the lower magnitude of the fine does not eliminate the risk that the firm may go bankrupt a result of the fine.

In a recent case, where the Commission fined 17 bathroom equipment manufacturers a total of €622m for a price fixing cartel covering six EU countries Joaquin Almunia, Competition Commissioner argued that ‘these 17 companies fixed prices for baths, sinks, taps and other bathroom fittings for 12 years in six countries covering 240 million people. The cartel will have harmed businesses such as builders and plumbers and, ultimately, a large number of families. However, as the objective of anti-cartel enforcement is not to precipitate the fall of companies in financial difficulties, the Commission reduced the fines on five companies to a level they could afford. Companies should be in no doubt that the Commission will continue its fight on cartels and the level of fines will continue to be such that it should dissuade them from engaging in illegal behaviour in the first place.’

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In the French beef\textsuperscript{107} case the Commission alleged that French federations in the beef sector were involved in a price fixing cartel. In the \textit{French beef} case\textsuperscript{108} the Commission considered the \textit{specific economic context} of the case. It emphasised that measures had already been taken under the Common Market organisation for beef in order to attenuate the crisis in the sector, and thus additional initiatives involving anticompetitive conduct could not be justified.\textsuperscript{109}

As the above analysis illustrates, the EU authorities have accepted the financial constraints argument in their assessment of cartels and have thus been lenient on the imposed fines. The existence of such an argument may incentivize parties in industries experiencing difficulties to conclude cartel agreements and then once caught, they can invoke this argument and achieve a reduced fine. Thus, the likely payoff of such a cartel agreement is higher than would be the case without invoking the financial constraints argument, and is likely to induce parties to engage in cartel agreements. The financial constraints defence does raise some complications as regards the


\textsuperscript{109} In December 2006, the General Court reduced the fines imposed by the Commission and stated, on the economic context, \textit{the economic context was characterised by the following factors: first, the drop in the consumption of beef as a result of the ‘mad-cow’ crisis, which affected a sector already in a difficult situation; second, intervention measures taken by the Community and national authorities aimed at restoring balance in the beef market; third, the loss of consumer confidence, linked to the fear of ‘mad cow’ disease; fourth, the situation of farmers who, despite Community adjustment measures applied by France, were faced with slaughterhouse entry prices for cows which were falling again, while consumer prices remained stable.} Fédération nationale de la coopération bétail et viande (FNCBV) and Fédération nationale des syndicats d'exploitants agricoles (FNSEA) v Commission of the European Communities (T-217/03 & T-245/03), 13 December 2006. Paragraph 356.
enhanced cartel incentives that it induces as well as the decreased deterrence. Thus, it should be used with caution. However, the viability of a company is a factor that should be taken into consideration by competition authorities when they set the level of the fine.

A market in which the number of firms will have been reduced due to bankruptcy of incumbents as a result of high fines is not enhancing consumer welfare at all. To the extent that the firms that exit the market are the least efficient ones, this is enhancing consumer welfare. Fines that cause a firm to go out of business may be beneficial to antitrust policy if bankruptcies lead to a reduction in over-capacity and a mitigation of inefficiencies. However, in periods of crises, firms may face liquidity constraints as well as decrease in demand that mitigates their efficiency. Thus, although in the absence of the crisis these firms would be operating efficiently, due to the crisis they face difficulties in their operation. Once though the crisis is over these firms are likely to return to efficient operation. Thus, although during a crisis a firm may appear to be inefficient and should not be prevented from exiting the market as a result of a high fine, in reality the exit of this firm may adversely affect the efficiency in the market once the crisis is over as efficient firms (which appeared inefficient due to the crisis impact) will have exited the market.

Without the industry wide agreement on capacity reduction that can be achieved through a crisis cartel, smaller firms may exit the market leaving thus a limited number of choices for customers as well as inducing unemployment. In such conditions, may operate at inefficient output levels and may even be incurring losses. The Treaty of Rome did not contain any clauses regarding crisis conditions. When the Treaty was signed, economic expansion seemed to be the likely to continue. Due to the lack of express clauses in the Treaty of Rome the Commission could not
justify applying the Article 101(3) criteria. Thus, the Commission initially reduced fines in cartels existing in situations of crises.

As the above analysis illustrates crisis cartel agreements should not be automatically prohibited and the financial constraints defence should be taken into consideration during periods of crises. Intuitively, between a market with a small number of remaining firms and a market with a significant number of firms which decide to coordinate in the reduction of capacity during the crisis, the latter alternative may be more beneficial for the market in the long term. We should note that in the latter scenario, as soon as the adverse conditions in the market that are due to the crisis cease to exist, the structure of the market that will result after the expiration of the crisis cartel agreement, (which should follow the positive developments in the market), is likely to have a greater potential to return to pre-crisis competition levels due to the survival and existence of a larger number of firms. Of course any likely adherence (either intentional or due to undertakings becoming used to behaving in a certain way) of the undertakings to the crisis cartel agreement should be assessed by the competition authorities and should be fined accordingly. Existence of criminal sanctions as well as of leniency programmes can ensure deterrence after the crisis period.

Crisis cartel agreements can ensure the sustainability of an industry that is in crisis. Such agreements need to satisfy the criteria the Commission outlined in the 23rd Report on competition policy. The Commission argued that\textsuperscript{110} it may condone such agreements which will aim at reducing the overcapacity as long as the agreement applies to a sector as a whole. Such

\textsuperscript{110} Point 84.
agreements will not involve price fixing or quota agreement and will not impair the free decision making of firms.

Such agreements need to operate within a specific timeframe which will not exceed the duration of the crisis. As regards the identification of the end of the crisis, economists argue that once the results at the end of a quarter show positive growth (irrespective of how low), the economy, which has been experiencing negative growth for two or more consecutive quarters (and thus is in crisis), has overcome the crisis. The equivalent analysis may apply to sectors of an economy if particular sectors are experiencing negative growth. Thus, the duration of a crisis cartel agreement can match the duration of the crisis that harms the sector/economy. Alternatively, depending on the case at hand, the cartel crisis agreement may have a one off implementation. Thus, there may be a one-off coordinated decrease in the capacity and then the firms will return to normal competitive interaction. The limited duration of the crisis cartel agreement will prevent any adherence of the undertakings to the cartelistic conduct as well as the repetition of such conducts.

Competition authorities should of course adopt a case by case approach in assessing crisis cartel agreements. As abovementioned, they should focus on the economic context related to each case. The Advocate General in Montecatini v Commission argued that it follows from the scheme of Article 101 that account is to be taken under Article 101(1) only of the elements of the legal and economic context which could cast doubt on the existence of a restriction of competition. \(^{111}\)

\(^{111}\) See in particular C-235/92 P Montecatini v Commission [1999] ECR I-4539, paragraphs 114-128. He added (and then explained) that in examining whether agreements like the BIDS agreements have as their object the restriction
In a recent case, according to the ECJ the BIDS arrangements were intended to enable several undertakings to implement a common policy which had as its object the encouragement of some

of competition, the following approach is to be taken. First of all, it must be considered whether such agreements have restrictions of competition as their necessary consequence or are aimed at limiting the freedom of the parties to determine their policy on the market independently (1) and thereby at affecting market conditions (2). Subsequently it must be examined as part of an overall assessment whether the restrictive elements are necessary in order to achieve a pro-competitive object or a primary objective which does not come under the fundamental prohibition contained in Article 101(1).

112 The issue in this case is whether the arrangements by the members of the Beef Industry Development Society Limited (“BIDS”) for the purposes of the rationalisation of the beef processing industry in Ireland through a mechanism of reduction of the overall capacity in the industry have as their object or effect the prevention, restriction or distortion of competition in the common market and therefore fall within the prohibition under Article 101(1). The BIDS was an industrial and provident society established by 15 beef processing companies in 2002, the members of which represented approximately 93 per cent of the market for the beef supply in Ireland. The second defendant was a beef processing company which reached an agreement with BIDS but had not taken an active part in the proceedings. The Competition Authority v. the Beef Industry Development Society Limited and Another [2008 E.C.C. 6, 113].
of them to withdraw from the market and the reduction, as a consequence, of the overcapacity which affected their profitability by preventing them from achieving economies of scale. In addition, the means put in place to attain the objective of the BIDS arrangements included restrictions whose object was anti-competitive.\footnote{113}{Including: the levy of EUR11 per head of cattle slaughtered beyond the usual volume of production of each of the stayers, restrictions imposed on the goers as regards the disposal and use of their processing plants, non-competition clause imposed on the goers.} Thus, a crisis cartel agreement that will not lead to exit of firms, but just to the reduction of capacity, may not be deemed as having its object the restriction of competition.

The Advocate General set out three categories in which the assumption of a restriction of competition may be rejected or at least doubtful on the basis of the factual or legal context.\footnote{114}{See further the Advocate General’s Opinion.} The first category of cases includes cases where a limitation of the freedom of undertakings to determine their policy on the market independently has no effects in relation to competition. This may be the case where it is doubtful whether the undertakings party to the agreement are competing among themselves\footnote{115}{Case T-374/94, European Night Services [1998] E.C.R. II-3141.} as well as where it is doubtful whether there is actually sufficient competition which can be restricted by the agreement.\footnote{116}{T168/01 - GlaxoSmithKline Services v Commission.} In periods of crises, the competitive interaction of undertakings may be at best limited. Due to the adverse market conditions and the stagnated demand, competition between firms may not be sufficient and thus, even if it is restricted, the assumption of a restriction of competition may be rejected or at least doubtful.
The second category concerns cases in which an agreement is ambivalent in terms of its effects on competition. If the object of an agreement is to promote competition, for example by strengthening competition on a market, opening up a market or allowing a new competitor access to a market, the necessary restriction of the requirement of independence can give way to the aim of promoting competition.\(^\text{117}\) Thus, if the object of a crisis cartel agreement is to sustain the viability of the firms in the market the assumption of a restriction of competition may be rejected or at least doubtful.\(^\text{118}\)

Finally, the Advocate General added that factors which are not capable of casting doubt on the existence of a restriction of competition, such as improvements in the production of goods as a result of economies of scale, may not be taken into account in the context of Article 101(1), but only in the context of Article 101(3), even where they are ultimately to be assessed positively in terms of an agreement’s compatibility with Article 101.


\(^\text{118}\) The Advocate General added a third category concerns ancillary arrangements which are necessary in order to pursue a primary objective. If the primary objective pursued does not come under the fundamental prohibition contained in Article 101(1) because it is neutral as regards competition or it promotes competition, the ancillary arrangements which are necessary to achieve that objective do not come under the fundamental prohibition in Article 101(1) either. A restriction of competition cannot be taken to exist in such cases. If, on the other hand, the primary objective pursued comes under the fundamental prohibition laid down in Article 101(1), there is a restriction of competition. See further: Case 42/84 Remia and Others v Commission [1985] ECR 2545, C-250/92 DLG [1994] ECR I-5641, C-309/99 Wouters and Others [2002] ECR I-1577, C-519/04 P Meca-Medina and Majcen v Commission [2006] ECR I-6991.
Crisis cartel agreements should not be automatically deemed illegal rather the aims and the effects of these should be assessed in order to balance the negative impact of crisis cartel agreements with the positive effects of sustaining the viability of undertakings in the market, which can ensure the availability of consumer choices once the crisis is over. Assessment of such agreements can thus be assessed pursuant to Article 101(3) in balancing the positive and negative effects of the agreement. Factors which are not capable of casting doubt on the existence of a restriction of competition, such as improvements in the production of goods as a result of economies of scale, may not be taken into account in the context of Article 101(1), but only in the context of Article 101(3), even where they are ultimately to be assessed positively in terms of an agreement’s compatibility with Article 101.

This strict case by case approach and the justification of the treatment of a crisis cartel agreement will prevent adverse precedential issues for competition authorities. Competition authorities need to make clear in their decisions that the approach they adopt in allowing a crisis cartel agreement has, as mentioned above, limited duration, applies to specific sectors and its justification is the adverse impact of the crisis on the specific sector. Following such an approach will prevent setting precedents which may unnecessarily complicate enforcement of competition in periods not characterised by crisis.

The Commission and the General Court/ECJ will authorize a restructuring plan involving sectoral agreements if it is believes 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 efficient capacity utilisation enhancing the competitiveness of the sector and thus benefiting consumers. In
addition, as the Commission interestingly argues a factor that will be taken into account is the impact of the capacity coordination on the mitigation of the adverse impact of the crisis on employment.\textsuperscript{119} The Commission explicitly states that \textit{reorganisation operations should also be used to stabilize and secure the employment situation in the sector concerned}.\textsuperscript{120} Again the Commission uses the positive impact of a coordination of business conduct of competitors on employment as a factor favouring exemption of the agreement. Thus, a detailed plan of plant closures as well as avoidance of creation of new capacity are also necessary factors in the agreement being accepted by the Commission. In addition, the agreement must constitute indespensible 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 the agreement as well as the fact that the coordinated reduction in capacity is only element in the business strategy of firms constitute reassurances that competition will not be eliminated.

Turning to the experience in US, even though, crisis cartels are not prevalent in the US caselaw,\textsuperscript{121} there have been voices in the academic literature that advocate the positive impact of crisis cartels. Tobriner and Jaffe argued that voluntary planned production should be tried tentatively in industries in which a condition of over-production is chronic. They add that in those industries where disparity between production and consumption causes waste, and injures the public, cooperation among producers should not be illegal. They provide the examples of the oil, gas, lumber and many natural resource industries, where competition has not only produced

\footnotesize{\textsuperscript{119} 23\textsuperscript{rd} Report on Competition Policy, point 85.}

\footnotesize{\textsuperscript{120} 23\textsuperscript{rd} Report on Competition Policy, point 88.}

\footnotesize{\textsuperscript{121} At least as the above tables show, crisis cartels even if they existed, they were not deemed acceptable.}
enormous waste-age, but the illegality of cartel agreements has prevented cooperation to avoid this loss. The authors are radical enough to propose that that the law should validate plans aimed to assist in the stabilization of an industry through the balancing of production to consumption, whereby economic waste in such industry will be reduced. They believe that such agreements should be excepted from the Sherman Act.  

In Addyston Pipe & Steel Co. v. United States, six iron pipes manufacturer companies decided to combine their efforts in order to fix prices and avoid competition between them. During the trial, the Defendants argued that their activities were legitimate, because the object of the association was to prevent ruinous competition. They claimed that the bonuses charged were not exorbitant profits but simple deductions from a reasonable price - a penalty intended for each member in case market player decides to get more than his due proportion. On these grounds, the Defendants stated that their activities involved a reasonable restraint of trade. Nevertheless, the Sixth Circuit deemed that the joint activities were contrary to the Sherman Act, which only allows a restraint of trade when: (i) it is ancillary to the main purpose of the lawful contract; and (ii) it is necessary to protect enjoyment of legit fruits or to protect from dangers. The Supreme Court later confirmed the illegality of the Defendant’s activities based on the fact that the manufacturers and seller of cast-iron pipe were in a concerted action to fix prices for pipe.


123 U.S. Supreme Court (1899) 175 U.S. 211.
In the *Window Glass* case,\textsuperscript{124} the machine manufacturers sought to put the hand manufacturers out of business. The hand manufacturers were saved quite unexpectedly by the hand workers, who accepted wage cuts and part-time work to enable the hand manufacturers to cut cost. To keep the industry functioning, the labor unions and manufacturers in the hand trade agreed that the various plants were to be run on part time only, work-hours apportioned among all the workers, and production quotas assigned to the manufacturers. This arrangement was sanctioned by the Supreme Court. The question presented to the Court was whether the agreement between the hand workers and the producers providing for periodic shut-downs and apportionment of hours among the workers was an unreasonable restraint of trade. The motive, said the Court, was the worker's desire to protect his job. Therefore, the agreement was not unreasonable.\textsuperscript{125}

In *United States v. Socony-Vacuum Oil Co*,\textsuperscript{126} there was a "General Stabilization Committee", with the object to eliminate price wars by negotiation. Major oil companies selling gasoline conspired together to raise and fix and maintain at noncompetitive levels tank car prices for gasoline in the "spot market' in the East Texas and Mid-Continent fields for jobbers and consumers. The conclusion was that defendants' purpose was not merely to raise the spot market prices, but to raise the price of gasoline in their sales to consumers as well. The alleged conspiracy was not registered in any formal contract or agreement, just based on testimonies and thousands of exhibits. This case was originally decided by a District Court which found 12

\textsuperscript{124} National Ass'n of Window Glass Mfgs. v. United States (1925) 263 U. S. 403, 44 Sup. Ct. 148.


\textsuperscript{126} U.S. Supreme Court (1940) 310 U.S. 150.
corporations and 5 individuals guilty with violations of Article 1 of Sherman Act. This decision was appealed and the Seventh Circuit reversed and remanded for a new trial. Finally, the Supreme Court ruled that a price fixing agreement is *per se* illegal under Section 1 of Sherman Act and that the elimination of “competitive evils” is not a legal justification for such agreements.

As the above analysis of the caselaw illustrates, the US competition authorities and courts have been less apprehensive of crisis cartels compared to the Commission and the CFI/ECJ. The US has been more strict on enforcing the *per se* illegality of crisis cartels. The only case in which the Supreme Court applied the rule of reason to a cartel is *Appalachian Coals, Inc. v. United States*,

127 involving a price cartel established under emergency circumstances in the coal industry. Thus, the Supreme Court accepted, albeit with within narrow limits crisis cartels. This decision which is an exception to the *per se* rule was based on a detailed analysis of the extraordinary circumstances of the case.

Intuitively, between a market with a small number of remaining firms and a market with a significant number of firms which decide to coordinate in the reduction of capacity, the latter alternative may be more beneficial for the market. We should note that in the latter scenario, as soon as the adverse conditions in the market that are due to the crisis cease to exist, the structure of the market that will result after the expiration of the crisis cartel agreement, (which should follow the positive developments in the market), is likely to have a greater potential to return to pre-crisis competition levels due to the survival and existence of a larger number of firms. Of

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course any likely adherence (either intentional or due to undertakings becoming used to behaving in a certain way) of the undertakings to the crisis cartel agreement should be assessed by the competition authorities and should be fined accordingly.

It is essential for competition authorities to consider such issues carefully following a pragmatic approach, as there is the risk of harm to consumer welfare as a result of strict and non-pragmatic enforcement of competition legislation. The Chairman of the Competition Committee of the OECD, Frederic Jenny noted that the biggest problem is to convince legislators or executive branches of the government that competition authorities can make positive contributions during crises and that competition law can be adapted in scope, time and focus. Thus, antitrust policy should be adapted in crisis situations in order to prevent the market from worsening further.

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CONCLUDING REMARKS

Professor Vives, in his presentation to the OECD\textsuperscript{129} interestingly argued that there is a trade-off between competition and stability. Bank runs could happen independently of the level of competition but an excessive level of competition tended to worsen coordination problems. Systemic crises tend to be less likely in concentrated banking systems. He added that institutions close to insolvency have incentives to gamble for resurrection and must be restrained in their competitive ability.

The concerns over how far should antitrust policy be flexible to support other objectives are important and likely to have wide ramifications given the governmental intervention in the financial markets, which has increased since the collapse of Lehman Brothers. The essential question is whether the usual framework for regulation of the competition impact of mergers is flexible enough to deal with such situations or whether it has simply been ignored in an attempt to restore tranquility in the financial markets. Competition authorities in the EU should have a tendency of being more flexible in the application of competition rules during a crisis, in order to overcome and soften the hard consequences that the latter entails on the European internal market.

The Chairman of the OFT, Philip Collins, in his presentation to the OECD, argued that the established principles of antitrust policy could not be disregarded because of the recession but

\textsuperscript{129} \textit{Summary Record of the discussion on Competition and Financial Markets}, DAF/COMP/M(2009)1/ANN4, 10 April 2009, \textit{Roundtable 3 on Real Economy and Competition Policy in a Period of Retrenchment}, \url{www.oecd.org}.
competition agencies and policies needed to adapt the way in which interventions were made, the kind of investigations carried out and the kind of instruments used, so that they were demonstrably relevant, timely and beneficial in both retrenchment and in recovery.\textsuperscript{130}

The UK response to the OECD states that competition law and policy should be flexible enough to accommodate a range of policy objectives. It adds that there may be compelling reasons to accept other concerns. \textit{In this changed climate, competition authorities will need to demonstrate pragmatism, but equally they will need to be effective advocates of competition within government and across the wider economy to ensure that the competition process is not compromised in the long-term.} Competition authorities will need to adapt quickly to changing priorities, and to display a degree of pragmatism by recognising occasions when other policy interests may over-ride antitrust policy.

Professor Ito argues\textsuperscript{131} that competition should be set aside in the financial crisis during a systemic crisis. He adds that in an acute crisis, protecting financial stability is of paramount importance to the economy. Vives argues that competition has to be restricted/regulated for companies close to insolvency and those which have received subsidies. According to him, the main aim of antitrust policy in times of crisis should be to preserve long term viability and the strength of competition in the financial sector. Thus, measures including merger policy should be flexible in the short term. He adds that a systemic crisis overrides antitrust policy concerns, and


importantly adds that banking is not like any other sector as regards antitrust policy. According to the author, merger policy should be more lenient in banking but consistent over time since the banking sector’s systemic character, and thus its specificity, in antitrust policy should be recognized. Philip Lowe though has argued, that it is necessary to recognise the systemic and special features of the banking sector, the reality that the banking sector is no different from any other sector in terms of the need to restructure, and to plan out what constitutes a return to viability.

As the OECD Report states, competition authorities have to remain firm on the principles and continue their efforts to promote and safeguard competition. It adds that things were not quite the way they used to be and some adaptation to new tools and new pressures coming from outside competition authorities would be needed, and there will be new enforcement issues, as well.

Professor Peltzman in his presentation to the OECD argued that the regulation that tried to head off a financial crisis was inherently anti-competitive, even in normal times. The tension between competition and solvency regulation, which is permanent, was resolved in favour of stability. He

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added that in the last few months, the ten biggest banks in the US had been told to sign an agreement which amounted to collusion. Both the US and the UK had, in effect, nationalised their banking systems and the banks were now effectively agents of the government. Firms that were deemed systemically important were subsidised, clearly against the spirit of the WTO and the EC. All this meant that the world had moved a long way from the tenets of competition policy in the crisis... For the future, it is clear that substantial government intervention in any future crisis is an absolute certainty and that intervention will be unrestrained by competition law.

As the analysis in this paper illustrates, competition authorities in the US and EU should be pragmatic in enforcing competition legislation against mergers, and cartels in periods of crises. As emphasized above, in adopting such an 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. Antitrust policy needs to be pragmatic, and flexible enough in order to address sudden exogenous shocks and the wide ranging implications of such shocks to whole markets. After all, the ultimate and undoubted aim of competition should be to enhance the degree of competition in a market, leading to improvement of consumer welfare. On a number of occasions, it is essential thus to subordinate antitrust 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 antitrust policy (e.g. systemic crisis, macroeconomic instability etc.).
Short-term anticompetitive measures introduced to counter a financial and economic crisis should not harm current and future market competition, must be as temporary and as limited as possible, and should promote resource reallocation rather than maintaining the status quo. Peter Freeman, Chairman of the UK Competition Commission, has argued that competition authorities should not expand their remit but rather look at and try and understand the full policy context.\textsuperscript{135}

Competition authorities must be allowed to focus on promoting competition through well-targeted interventions while remaining mindful of the situation in the wider economy and the broader policy concerns that governments may need to address. Public policies should not aim at supporting firms who were in distress independently from the crisis.

Frederic Jenny opening the discussion in the roundtable \textit{The Role of Competition policy in Financial Sector Rescue and Restructuring}\textsuperscript{136} mentioned that as regards the management of the crisis from the point of view of antitrust policy antitrust law enforcement might be too narrowly focused in the financial sector and the concept of efficiency might need to be enlarged to include stability. Antitrust policy played a useful role in a period of crisis but might need to be a secondary concern during such times. This approach is the key to the long-term benefits of competition for consumers and for the economy as a whole in terms of growth and increased productivity.

\textsuperscript{135} P. Freeman ‘\textit{Competition Policy after the Credit Crunch: The view from a UK competition authority}’, Chatham House Conference, 26 June 2009.
