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COVID-19: Will Today's COVID-19 Distressed Businesses Become Tomorrow's Antitrust-Cured Acquisition Targets?

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Despite the unprecedented efforts and measures undertaken by governments across the world to mitigate the economic impact of the COVID-19 pandemic, it is an unfortunate but inevitable outcome that a number of businesses are going to fail. Some will file for bankruptcy, while others, seeing the handwriting on the wall, may put themselves up for sale in an effort to avoid a bankruptcy filing. These business failures may present their competitors who are able to successfully weather the economic storm with some acquisition opportunities that might not otherwise be possible under antitrust laws. Below, we discuss the "failing firm" defense in merger reviews and how it could increasingly come into play in the near future as a result of the economic impact of COVID-19 and "cure" otherwise problematic acquisitions. We also discuss steps companies can take to improve their chance of success in asserting the defense.

Failing Firm Defense in the United States

COVID-19 has not prompted the U.S. government to create any special antitrust rules for merger review. Rather, the Merger Guidelines already used by the Department of Justice Antitrust Division and Federal Trade Commission (the "Agencies") in their merger review contain special provisions to deal with failing firms and even failing divisions within firms.[1] In general, the Merger Guidelines are designed to help the federal antitrust enforcers identify acquisitions that would reduce competition — something that may happen when one competitor acquires another, and there are not "enough" competitors remaining in the market. However, the Guidelines recognize that if a company (or division) is going out of business anyway (e.g., because it cannot meet its financial obligations in the near future and it would not be able to successfully reorganize under Chapter 11 of the Bankruptcy Act), then its acquisition by a competitor is not going to lessen competition; the number of competitors is going to be reduced by one in any event. This is referred to as the "failing firm" defense.

There is a wrinkle here: the failing company (or division) has to show that it made efforts to obtain reasonable alternative offers, but often times, the only companies interested in acquiring a failing

company are its competitors — the ones who are already familiar with the market in which they compete. In that scenario, the question of which suitor is the most desirable one from the standpoint of not reducing competition may not have a clear answer.

The failing firm defense generally has a high burden of proof, but if met, it acts as a complete defense. For companies unable to meet this burden, the Agencies recognize the “flailing firm” defense or “weakened competitor” defense. While the flailing firm defense is not absolute, it does offer an alternative where a company’s competitive position has declined or is likely to decline in the near future, but it may not go out of business.

Failing Firm Defense in Europe

The failing firm defense is also available in Europe. The EU merger control regime, which is largely mirrored in the national laws of EU member states in this respect, expressly recognizes that an otherwise problematic merger may nevertheless be compatible with EU competition law if one of the merging parties is a failing firm. The critical factor is whether the market structure without the merger would be essentially no better than that which would result from the proposed acquisition.

The so-called “failing firm defense,” although notoriously difficult to argue successfully, is expected to have a renewed relevance in the current climate. For example, the UK’s Competition and Markets Authority (CMA) recently cleared an acquisition quoting the target’s financial position caused by COVID-19 as the main factor behind the regulator’s decision. Although after its Phase 1 review the CMA was concerned that the transaction could damage competition, it cleared the deal concluding that (i) the target’s exit from the market was inevitable without additional funding, and that (ii) the acquirer was in a unique position and only they would be willing and able to provide such funding during the outbreak. Despite the CMA describing the circumstances as “*wholly unprecedented*,” they are arguably only unprecedented when compared to the pre-COVID-19 market conditions, with many more businesses currently being at risk of facing similar issues and having an extremely limited pool of bidders with resources.

On 22 April 2020, the CMA in fact published guidance on how it is likely to approach failing firm claims specifically in the context of the COVID-19 pandemic. The CMA essentially notes that it will use the existing framework and will analyze these submissions in a fair and transparent way, regardless of whether the transaction has already completed or not.

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