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The role of competition advocacy, merger control and the effective enforcement of law in times of economic trouble

Note by the UNCTAD secretariat

Executive summary

This paper is a background report discussing the various approaches taken by competition authorities in response to the challenges arising from the global economic crisis in order to achieve effective enforcement of merger control. The paper suggests that, just as the effects of the recession went beyond the markets in which it originated, so too must the outlook of competition policy enforcers when applying competition policy and merger control. For enforcement to be effective, governments should endeavor to minimize any negative impact on competition arising from their interventions and account for the risk of creating adverse consequences in other states given the global dimensions of many markets. Therefore, anti-competitive practices require global coordinated responses.

In addition to increased coordination, the paper proposes that effective enforcement of competition policy and merger control requires that national laws are enforced with consistent rigor throughout the economic cycle and not relaxed in response to a recession. Furthermore, the paper draws attention to the increased importance of the role of competition advocacy during periods of economic troubles, stating that the effective enforcement of competition policy requires that competition advocacy is broadened to wider policy areas without compromising on the independence of competition authorities.

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Introduction

A. Background to the financial crisis

1. The recent global financial crisis is said to have been caused by a combination of major strategic errors and recklessness by banks and weak regulation. Banks, driven by biased incentives, borrowed and lent excessively and way beyond their capital availability, leaving them exposed when the asset price bubble burst and triggered large-scale defaults. These effects spread globally due to the sale and purchase of opaque credit default derivatives between financial institutions worldwide.

2. September 2008 saw the crisis reach full swing as the investment bank Lehman Brothers, Wall Street's fourth-largest bank, filed for bankruptcy. Soon after, the world's credit markets froze, stock markets crashed and other major financial institutions failed in quick succession; first in the United States, then in Europe and further afield. The shock to the banking system meant that banks were unable to extend credit to undertakings in the real economy, broadening the effects of the crisis to beyond just financial markets. The threat of systemic failure of the entire international financial system and a full blown global economic recession loomed. Pressure mounted for governments, particularly in the developed world, to take swift steps to stop domino effect of bank failure, set right the financial markets and bring about economic recovery.

3. Responses to the global financial crisis took various forms of government intervention including, inter alia:

(a) State bailouts of firms (largely but not limited to institutions in the financial sector);

(b) The provision of cash injections into financial systems to keep credit flowing, usually in exchange for large equity stakes in the beneficiary;

(c) The encouragement of mergers in the financial sector resulting in the creation of "mega banks"; and

(d) Requiring competition authorities to apply "light touch" enforcement of competition rules in order to clear otherwise questionable mergers and alliances.

(See the box below for more specific examples of measures adopted by governments worldwide to counter the effects of the financial crisis and global recession).

4. Political pressure therefore became increasingly influential on competition policy implementation. For example, the European Commission (EC) was essentially forced to shift its policy on the application of State aid rules in relation to financial institutions in response to the rescue measures taken by governments to support their financial sectors. Given that numerous EU governments had already granted aid to flailing institutions in contravention to State aid rules, some say that the EC had no choice but to institute such amendments in order to prevent State aid rules from being openly flouted and to counter political pressure that called for the complete disapplication of the rules.

5. Succumbing to systematic political pressure to relax competition rules and enforcement can have adverse consequences on competition both at domestic and international levels and delay global recovery. The global nature of markets and the widespread reach of the recession highlight the external impact economic activities in one country may have on the markets of another. As discussed in chapter II below, for competition to be enforced effectively, it is vital that countries do not solely pursue their

own national interest but take a broader approach to consider the impact of their policy on competition in other countries.

B. Effects on merger control

6. Mergers affect market composition and structure and impact policy areas beyond competition. For example, a large proportion of foreign direct investment (FDI) takes the form of mergers and acquisitions and is often encouraged by governments, particularly in developing countries seeking growth. During the recent financial crisis, acquisitions of large firms in financial difficulty were often welcomed by governments as they removed the need for any financial expenditure on the part of the government to save the company. Competition policy, which seeks to regulate and prevent mergers that may have an adverse effect on competition in the market, may clash with such policy objectives. Mergers therefore lie at a crossroads between industrial, political or economic policy objectives. Addressing how to approach merger control in times of economic trouble presents a considerable challenge to competition authorities worldwide.

7. Key developments in merger activity and the enforcement of merger control during the recent downturn are summarized as follows:

(a) Increased pressure on governments to relax merger control laws and standards of enforcement on the whole. This presented a major challenge to competition authorities who in certain jurisdictions saw their role sidelined in favour of the pursuit of other often short term policy objectives;

(b) State-backed or instigated mergers were often used in conjunction with large stimulus packages as part of wider government policy for recovery. Again, this had implications for merger control enforcement due to the influence of potentially conflicting policy objectives behind such mergers;

(c) The crisis increased the level of complexity in the substantive analysis of merger decisions. Counterfactual analysis[1] moved into uncharted territory, requiring a dramatic shift from the preceding 15 years of continued growth and stability in most economies to limited access to financing and crashing demand. More specifically, there was a rise in the number of firms suffering some form of financial distress which resulted in the increased use of the failing firm defence in relation to otherwise anti-competitive mergers. This presented challenges not only in relation to the substantive analysis but also in terms of remedies. For example, the reduced number of buyers able to purchase divestments due to constrained access to finance limited the capacity of competition authorities to impose structural remedies;

(d) There were procedural implications on competition authorities who fell under pressure to respond quickly to applications due to the fragility of the market and financial instability of undertakings raising concerns as to the quality of the substantive assessment.

8. The paper is organized as follows. Chapter I espouses the need for global cooperation on competition enforcement in order to achieve effective enforcement of merger control, particularly in times of economic trouble. The chapter discusses the global nature of competition and the need for competition authorities to lay greater emphasis on the broader global repercussions to competition when enforcing merger rules nationally.

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[1] Counterfactual analysis is a means by which competition authorities are able to predict the potential impact of a merger on the relevant market. It involves making a comparison between existing competitive structure on the market and the future composition of the market should the merger in question occur. The aim is usually to decipher whether or not there will be a lessening of competition as a result of the merger.

Chapter II highlights the benefits of robust enforcement of existing national competition laws during economic crisis and resisting pressure to relax enforcement for short term policy gains. The chapter also draws attention to the need to address limitations in competition regimes that hinder. Chapter III discusses the role of advocacy in achieving effective enforcement. The chapter calls for the broadening of competition advocacy to wider policy areas in order to limit anti-competitive mergers and promote alternative options. The final chapter provides some concluding remarks and raises issues for discussion.

Global State responses to the economic crisis 2008–2009

Developed countries: Overview

As the birthplace of the global economic crisis, the developed world, the United States and European markets in particular, were heavily affected by the crisis. In response to the enormous economic strain governments took unprecedented steps to assist systemically important financial institutions on the verge of bankruptcy.

United States

- A $787 billion fiscal stimulus package was introduced.
- Various mergers were permitted that would substantially increase the concentration of the United States financial markets, including the purchase by Bank of America of Merrill Lynch, creating the worlds' second largest bank by market value.
- The Federal Reserve leant insurance giant American International Group (AIG) $182.5 billion in exchange for a 79.9 per cent stake in the company.
- The United States Government purchased a further $250 billion worth of shares in nine major United States banks.
- Struggling automobile giants General Motors Corporation and Chrysler LLC were granted multiple loans by the United States Treasury, saving them from bankruptcy.

European Union

- A combined EU-wide fiscal stimulus package of €200 billion ($264 billion) was introduced amounting to approximately 1.5 per cent of GDP.
- The EC fast-tracked the approval of bank bailout plans and quickly put together Europe-wide guidelines allowing national guarantee schemes for bank deposits for up to two years, relaxing EU State aid rules where it was deemed "necessary to cope with the current turmoil in financial markets".

United Kingdom

- A £850 billion rescue package was introduced for banks.
- Lloyds TSB bank was allowed to purchase HBOS, the country's largest mortgage lender, for £12 billion ($18.9 billion). The transaction was said to potentially amount to a substantial lessening of competition in certain markets (e.g. personal current accounts and mortgages) by the Office of Fair Trading (OFT), the United Kingdom's competition authority.
- United Kingdom mortgage lenders, Northern Rock and Bradford & Bingley Plc were nationalized. Spanish Bank Banco Santander SA purchased Bradford & Bingley's retail deposits and branch network.

Japan

- A stimulus package worth ¥15 trillion (3 per cent of GDP) was introduced.
- The Bank of Japan offered up to $10.2 billion in subordinated loans to banks to bolster their depleted capital.
- The Legislature amended its merger-control laws in order to simplify the merger-review process.

Republic of Korea

- The Government introduced a $130 billion rescue package offering State guarantee on foreign debt and promising to recapitalize financial firms.
- Law makers also amended merger control laws to simplify review procedure.
- The Government cut purchasing and registration taxes by 70 per cent for customers buying new cars to replace old ones.

Developing/transitioning countries: Overview

According to the World Bank, developing and transition economies were sharply affected by the global economic downturn. By the first quarter of 2009, 25 of 31 developing countries for which quarterly national account data are available had reported negative growth rates.

Brazil

- The Government reduced the level of compulsory reserve holdings by banks and the created incentives for large financial institutions to purchase loan portfolios of smaller banks.
- The State encouraged Government-owned or controlled banks to expand their credit operations by granting federal loans to the National Development Bank (BNDES) and other institutions of up to 115 billion reals (4 per cent of GDP) between 2009 and 2010.
- The Government created credit lines for exporters, sale of foreign exchange swaps by central banks and the alleviation of the tax burden on selected financial operations.

China

- The Government introduced economic stimulus plan worth of ¥4 trillion ($586 billion).
- The stimulus package involved various financial assistance measures such as rebates and fiscal measures aimed at strengthening priority sectors.

I. Effective enforcement: The need for cooperation

A. The global nature of competition

9. The global trend towards trade liberalization and deregulation in the 1980s resulted in a mass migration away from industrial policies[2] and towards competition policies.[3] Today, over 100 countries have functioning competition authorities (with China and India being amongst the most recent additions to that list) in contrast with 10 years ago, when there were just 14. Whilst attempts to develop multilateral competition rules have been unsuccessful there is no doubt that today competition is a global phenomenon and that some form of coordination between the world's competition authorities and regimes is essential.

10. Proliferated trade liberalization also led to the significant growth of FDI, a substantial part of which took the form of mergers and acquisitions. This development makes cooperation particularly relevant to the context of merger control. Today the range of markets in which businesses can operate has significantly broadened, expanding the extra-territorial reach of mergers. Most large mergers between United States or EU corporations now require approval from multiple competition authorities worldwide. Increased coordination of enforcement procedure and standards between competition authorities therefore benefits the business community as it reduces transaction costs and lessens the burden of multiple jurisdictional reviews of the same transaction. More importantly here, to the extent that a merger impacts competition in other jurisdictions, increased cooperation can be instrumental in addressing the concerns of other nations' competition authorities. This requires policy makers to perceive the 'competition area' as legal rather than political or policy-infused.

11. As mentioned above, times of economic troubles are characterized by a distrust or increased intolerance of competition values, despite their long term benefits and instrumentality in relation to economic recovery and growth (see chapter II below). Cooperation is more important than ever during economic downturn in order to counter pressure and temptation to succumb to calls for the relaxation merger control in a bid to achieve stability at all cost. Consideration that anti-competitive policy may be felt further afield and have an overall adverse effect on competition will also reduce the potential for conflicts between governments and allow a level playing field to be more easily achieved.

B. International instruments and organizations on competition

12. Cooperation is at the heart of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (Set), negotiated under the auspices of UNCTAD, as well as various instruments of the Organization for Economic Cooperation and Development.[4] Both the Set and OECD instruments provide that there should be international collaboration to eliminate or deal with effectively restrictive business practices (RBPs) that affect international trade and recommend the adoption or maintenance and effective enforcement of competition laws and policies. Specific suggestions for coordination between competition authorities provided by the Set and

[2] *Industrial policies* generally involve concerted, focused and conscious efforts on the part of government to encourage and promote specific industries or sectors.

[3] *Competition* describes the struggle for superiority which, in a commercial context, means a striving for the custom and business of players in the market place.

[4] The OECD instruments apply to the restricted group of its members.

OECD instruments include notification, consultations, the exchange of non-confidential and confidential information (subject to safeguards), the coordination of investigations, investigatory assistance, and conciliation mechanism to minimize conflicts in the enforcement of competition laws. In addition, the Set draws attention to the need for developed countries to consider the development, financial and trade needs of developing countries, particularly the least developed countries (Art. C.). The Set urges states to go as far as possible to implement appropriate measures to control RBPs when they become aware that such activities adversely affect international trade.

13. Operating at a less formal level, the International Competition Network (ICN) is a forum that promotes international cooperation of enforcement of merger control through informal dialogue and exchange of best practice. The organization's mission in relation to merger control is to promote the adoption of best practices in the design and operation of merger review regimes in order to enhance the effectiveness of each jurisdiction's merger review mechanisms, facilitate procedural and substantive convergence, and reduce the public and private time and cost of multijurisdictional merger reviews.[5]

14. Much progress has been made worldwide to achieve the kind of cooperation described above and the benefits of such coordination were demonstrated on a number of occasions during the recent crisis. The EC, for example, was particularly conscious of the necessity to "maintain a level playing field and to make sure that national measures would not simply export problems to other member States." The EC took measures to avoid a subsidy race among member States by promoting compliance to single market principles such as non-discrimination and proportionality. These efforts were of course focused on a regional EU level.

15. Another example of coordination in action at a regional level can be found in the Nordic countries. This group of countries expressed an appreciation for the need to coordinate their approach to competition law and policy in order to achieve the level international competitiveness to which they aspire. Their recent report on competition policy and the financial crisis provided a detailed analysis of the effects of the economic crisis on their economies and gave an outline of their approach to dealing with the challenges faced. The group agreed on the basic notion that competition policy should not be weakened in times of crisis and provided suggestions on common approaches towards enforcement in all areas including merger control (Nordic Competition Authorities).

16. Cooperative efforts were also made on a bilateral level during the recession. The Republic of Korea Fair Trade Commission and the EC formally agreed to cooperate and increase convergence on competition policy and enforcement. This included cooperation on the review of mergers and acquisitions and reciprocal notification of enforcement activity that may have an impact on the other jurisdiction. The two authorities also agreed to share information, coordinate enforcement activities, protect confidential information furnished by the other authority and various other measures aimed at facilitating a close working relationship between the authorities. In a similar vein, the Japanese legislature amended its merger-review process to more closely conform to EU and United States processes and to reduce the number transactions subject to their notification requirements.

17. For specific examples of the potential content of such coordination agreements we may turn to the Cooperation Protocol for Merger Review between the Australian Competition and Consumer Commission (ACCC) and the New Zealand Commerce Commission (NZCC). The agencies agree that they would inform each other about merger transactions that may involve trans-Tasman operations or impact the other country's

[5] See http://www.internationalcompetitionnetwork.org/working-groups/current/merger.aspx.

market. They would also seek permission from any notifying parties to inform the other agency of such a merger. Other provisions agreed upon to streamline enforcement activities include, inter alia:

(a) *Timing* – As far as it is possible the agencies endeavour to run assessment timetables bearing in mind the differences between their respective processes;

(b) *Confidentiality waivers and collection of evidence* – The agencies seek broad confidentiality waivers from merging parties so that information on the transaction can be shared with the other agency in order to improve communication and achieve a more informed, timely and effective decision-making process;

(c) *Substantive assessment* – The agencies agreed to liaise extensively with one another through the course of the review process sharing information and comparing analytical approach to evidence;

(d) *Remedies* – The agencies agreed to make efforts to facilitate the compatibility of remedies accepted in ether jurisdiction and as discuss mutually compatible remedies and where possible, share draft remedy proposals for comments and participate in joint discussions with merging parties and relevant third parties.

18. A lesson to be learned from the ACCC and NZCC agreement is that cooperation agreements must take into account similarities and differences between the legislative context and review process between the different agencies. For example, whilst both New Zealand and Australian merger review notification requirements are voluntary, the levels of formality in the review process differs substantially with the Australian system being very informal. It is therefore necessary for such agreements to contain the requisite level of flexibility to allow for differences of approach whilst not compromising on the objective to capitalize on coordination and information sharing.

19. Whilst there has been this trend towards coordination (particularly at bilateral and regional levels) this has tended to be amongst OECD member States and there are relatively few bilateral agreements either between the competition authorities of the developed and developing countries or even amongst developing countries. More progress needs to be made to identify the reasons behind this pattern and achieve more widespread coordination and consistency so that consideration of extraterritorial competition effects of domestic policies affecting mergers become ingrained within all competition law and policy regimes.

II. Enforcement of existing law and policy

A. Maintaining the status quo

20. Calls for the relaxation of competition policy, adoption of protectionist policy, State assistance for firms in difficulty and less stringent enforcement of competition law are stepped up in times of recession. Although there was widespread agreement amongst competition authorities that competition policy and thus merger control should not be relaxed during times of recession, many governments have nonetheless succumbed to such calls, primarily but not exclusively, in relation to the banking and finance sectors.

21. The appeal to relax merger control enforcement in favour of State intervention in relation to the banking and finance sector is easy to understand. The special characteristics of the banking and finance sector make it more susceptible to systemic risk than other markets. Banks and other financial operators are heavily reliant on confidence of their customers because they need to be trusted to lend more than they receive. Furthermore, operators in financial markets are heavily interdependent. Therefore, unlike other sectors,

the failure of one bank is capable of undermining confidence in the banking and financial system as a whole and may lead to the collapse of that system. Government intervention to protect financial institutions from failure was therefore justifiable to the extent that the cost of the alternative (i.e. waiting for the markets to self-correct and potentially allowing the collapse of multiple financial institutions) would be too high. State intervention was also useful to quell increasing social unrest and allay the erosion of business confidence. Furthermore, relaxation of enforcement in merger control presented a “cheap fix” for governments as it removed the necessity to disburse funds from the public budget.

22. Despite these apparent benefits, the long term repercussions should be noted. Under normal economic circumstances, competitive markets work for the benefit of consumers and efficient firms. During an economic boom there is expansion and lots of entry into new markets. Efficient undertakings benefit from good investments and make profits. During a downturn, firms contract and leave markets in order to adjust to reduced customer spending. Inefficient firms with least attractive products and or highest costs exit the market, making room for more efficient firms to expand and new firms to enter the market when the economy picks up again. And so the cycle continues; the exit of firms, like their entry, being integral to the market mechanism. Competition law and policy prevents the artificial manipulation of this pattern through firms conspiring amongst themselves to bypass the effects of the market and obtain market power by fixing prices, excluding efficient rivals, merging with significant competitors or receiving discriminatory state subsidies or protection.

23. The emasculation of such laws and policies due to short-term difficult economic circumstances undermines the market mechanism and leads to adverse medium- to long-term consequences. Over time, prices generally increase to the disadvantage of consumers, and product quality suffers as there is reduced incentive to innovate as input costs are lowered. The overuse of interventionist policy may also authenticate the reckless behaviour of recipient companies, such as banks, that appear above reprimand given their size and importance to the market; an issue that gained much publicity in the recent recession as banks were bailed out essentially on the basis that they were “too big to fail”. Whilst players such as the shareholders and management in the industry benefit from relaxations in competition policy and merger control rules, the costs are felt by the ultimate consumers as well as efficient and competitive firms not party to such activity.

24. Another real danger with the approach of setting aside competition policy and merger control rules in exchange for State intervention and industrial policy is that government interventions may simply not work. Regulators often get it wrong and despite good intentions it could be the case that their efforts are in vain. One needs only to examine the repercussions of industrial regulatory policy enacted in past recessions and financial crises for evidence of the arbitrary effects anti-competitive industrial policy had on economic recovery.[6] With the limited exception of the banking and finance sectors, for which one must take into account additional vulnerability due to its special characteristics, the relaxation of competition policy and merger control enforcement is usually an inefficient and counterproductive means to achieve economic recovery and in fact may slow the process of economic recovery.

25. During the recession, there was general consensus amongst competition authorities worldwide that, as far as it was possible, competition policy and merger control enforcement should not be weakened. Authorities in the EU, United States, United

[6] There are similarities between justifications used to overrule competition law and pass through potentially anti-competitive mergers in response to the American financial panic of 1907 and the subsequent recession in the 1930s. It is widely agreed that these practices led to a slowdown in economic recovery.

Kingdom, China and the Nordic countries, amongst others, were at pains to reiterate the importance of adhering to competition policy during difficult economic times and emphasized that their existing regimes were well equipped to deal with the specific challenges to competition emerging during a recession. Nonetheless, the impact of the economic crises on the practicalities of competition enforcement cannot be ignored. Competition authorities were tasked with the unenviable job of maintaining a realistic attitude, accounting for the fact that an economic crisis can be an abnormal context in which to assess merger transactions whilst ensuring that competition was not adversely impacted. They succeeded to varying degrees. Some of the efforts made in response to the crisis in relation to merger control are now discussed.

B. Procedural changes

26. Ms. Neelie Kroes (former EC Commissioner) on numerous occasions strongly expressed the necessity to view competition as part of the solution to the crisis, stating that going "soft on enforcement" would do no favours to the economy. With regards to merger control, Commissioner Kroes vowed to continue applying the existing rules whilst taking full account of the economic environment. Her successor, Mr. Joaquin Almunia, more recently echoed this approach, emphasizing the need for competition enforcement in general to be strong in times of economic crisis. Similarly, the United States Assistant Attorney General, Ms. Christine Varney, stated that vigorous antitrust enforcement is a crucial component for economic stability.

27. "Taking full account of the economic environment" translated into at least two derogations from existing procedural practices which, arguably, resulted in the relaxation of competition law and policy pertaining to merger control.

1. Derogation from standstill periods

28. Many merger control regimes impose statutory waiting or "standstill" periods preventing firms from merging before competition authority clearance has been granted. Authorities showed increased flexibility in their willingness to dispense with the standstill obligation, allowing immediate implementation of transactions or assistance to be given from one party to another before clearance from competition authorities. In taking this approach, competition authorities sought to address the coinciding policy objective of securing financial stability by reducing delays for mergers involving parties in financial distress and where, due to the rapidly declining financial viability of a party, time was of the essence. The EC's stance was that such derogations would be granted where there were no obvious competition concerns, however this approach was adopted for even for complex cases where competition concerns were present and divestments imposed.[7] Other authorities also adopted this increased flexibility. The Belgian authority for example, granted its first-ever derogation from a standstill period during the Belgian State's acquisition of its stake in Fortis through the Belgian Federal Participation and Investment Company.

2. Shorter review periods

29. Some authorities made efforts to substantially reduce their review periods during the recession particularly for the benefit of firms in financial difficulties. Again, the EC led in

[7] For example, in the *BNP Paribas/Fortis* merger, the Commission allowed BNP Paribas to monitor Fortis's Belgian trading floor activities prior to approval of the transaction and also did not object to BNP Paribas' injection of substantial amounts of capital into the target to prevent its collapse.

this regard, in some cases conducting complex analysis and reaching a decision 10 working days earlier than the legal deadline. In the United States, provisions in the Hart–Scott–Rodino Antitrust Improvements were used to grant early termination of waiting periods for cases presenting no obvious antitrust concerns. These provisions, together with close cooperation between the Department of Justice (DOJ) and financial industry regulators such as the Federal Reserve, allowed the swift review and clearance of numerous potentially problematic combinations such as Wells Fargo/Wachovia, JPMorganChase/Washington Mutual, and Mitsubishi UFJ/Morgan Stanley. The Chinese Ministry of Commerce also took this approach, expediting the Fiat/Chrysler merger for reasons of financial exigencies.

30. Whilst times of economic trouble require competition authorities to be increasingly conscious of coinciding policy objectives such as stability, the effective enforcement of competition requires authorities to remain consistent and true to their assertions that the substance of competition law and policy should be maintained throughout all stages of the economic cycle. Increased procedural flexibility may remove procedural merger review obstacles and better accommodate transactions designed to accelerate a return to economic stability. Nevertheless, it is imperative that these changes do not affect the substantive analysis to the detriment of competition. Again, increased cooperation between global competition authorities will help to set the standard and create greater accountability in relation to the actions of national competition authorities and governments.

C. Substantive changes

31. On the whole relatively few jurisdictions adopted substantive changes to their merger control regimes in response to the global recession, largely convinced that the existing framework was sufficient to deal with the issues spurred by the crisis. In fact certain jurisdictions used the recession as an opportunity to bolster the capabilities and resources of their competition authorities and policy. In Mexico, for example, there are now plans to introduce reform to the competition regime in order to increase the legal powers and enforcement tools of the competition authority and enhance the overall competitive environment of the economy.

32. The crisis did, however, highlight certain areas of divergence amongst legislative frameworks worldwide particularly in relation to:

(a) The failing firm defence;

(b) Merger notification requirements;

(c) Public interest overrides (including examples from the banking and finance sectors); and

(d) Remedies.

1. The failing firm defence

33. Generally, the failing firm defence permits a merger that may otherwise be deemed anti-competitive on the grounds that, without the merger, one of the merging parties and its assets would exit the market. Thus the merger is justified as a “lesser evil” in terms of its effects on competition in the relevant market. Numerous jurisdictions worldwide have such provisions within their competition framework, but the circumstances required to qualify for such a defence rarely come about. That is, until the advent of a protracted global recession.

34. In line with popular rhetoric relating to the role of competition policy during the recession, competition authorities, governments and academics worldwide were vocal in their belief that the failing firm defence should not be exploited to allow anti-competitive

mergers to be passed *en masse* during the recession. Even so, certain authorities were open to individual failing firm arguments in light of difficult economic circumstances faced at the time. The United Kingdom's OFT, for example, accepted a failing firm defence in a merger between two leading United Kingdom high street retailers, HMV and Zavvi on the grounds that it was inevitable that the 15 Zavvi stores would otherwise have exited the market and that the merger would not be harmful to the relevant markets. Similarly, New Zealand's Competition Commission accepted the failing firm defence and for the first time released guidelines on the application of the doctrine.[8]

35. In some jurisdictions, the recession highlighted problems resulting from the absence of a failing firm defence. Mexico's competition regulations do not include a failing firm defence provision but since the recession there have been calls for the competition law to be modified to include a failing firm defence in order address the current ambiguity which allows room for non-transparent discretion when assessing mergers involving firms in financial trouble.

36. Although the incidence of mergers meeting the criteria for the failing firm defence should inevitably rise during periods of economic crisis, authorities needs to ensure that they adhere to the fundamental purpose of the failing firm defence and do not allow it to be used to serve wider objectives to the detriment of competition. The infrequent application of the failing firm defence makes this an ideal topic for international cooperation.

2. Merger notification requirements

37. Merger notification requirements vary across global competition law regimes. These variations fall into two broad categories: those that mandate notification prior to the completion of a merger transaction ("mandatory pre-notification regimes") and those that leave it to the discretion of the merging parties or allow them to notify authorities after the merger has completed ("voluntary regimes" and "post-merger regimes").

38. Undertakings merging in many jurisdictions (particularly older, more established ones) with voluntary regimes may in practice seek some sort of formal or informal clearance from authorities. Nevertheless, in a recession where there is added pressure for market consolidation, it is clear that a mandatory pre-notification regime would increase the capacity of competition authorities to provide an analysis of the likely impact of a given merger on competition. Voluntary and post-merger regimes on the other hand make the job of enforcement more complex and increases the risk of anti-competitive mergers completing unchallenged. That said, it should be noted that a mandatory notification regime may present an increased burden on both notifying parties and competition authorities alike. The approach adopted should therefore consider any limitations on resources faced by the particular authority.

3. Public interest overrides

39. As mentioned above, the presence of an economic recession brings forth coinciding and sometimes competing policy objectives when mergers are considered. At such times, non-competition objectives such as stability often impact merger clearance decisions. A balance must be struck between short-term gains in stability and the long-term benefits of sustaining competitive markets. Public interest overrides are included in the legislative framework of some jurisdictions, allowing governments to overlook merger rules so that more pressing public interest objectives are served. The use of public interest overrides during the recession was varied. Some jurisdictions – including the EU, United States,

[8] See http://www.comcom.govt.nz/media-releases/detail/2009/commercecommissiongrantsclearancet.

China and Japan – chose not override merger rules[9] whilst others – such as the United Kingdom, Italy and Brazil – resorted to public interest exceptions in isolated cases.

40. The Lloyds/HBOS merger case in the United Kingdom is one of the most prominent examples of the use of public interest overrides in response to the recent downturn. The OFT's analysis concluded that the acquisition of struggling HBOS (then the country's largest mortgage lender) by Lloyds TSB bank could amount to a substantial lessening of competition in certain aspects of the banking market. Despite this, the United Kingdom Government granted itself new competition powers on merger control, introducing a new public interest intervention allowing the United Kingdom Secretary of State for business enterprise and regulatory reform to intervene in the merger review process and prevent a reference to the United Kingdom's Competition Commission. The new public interest said to have been protected was the "stability of the United Kingdom financial system" which, it was decided, outweighed the OFT's concerns that the merger may be anti-competitive.

41. There is no question that there was full transparency and adherence to legal procedure in the intervention of the Secretary of State, who acted on the advice of the United Kingdom's HM Treasury, the Bank of England, and the Financial Services Authority. However, there has been much criticism of this move, as there is concern that the merger may result in the long-term lessening of competition in the already highly concentrated financial markets in the United Kingdom. Furthermore, many have questioned the necessity of the move in light of the extensive stimulus afforded to the financial sector after the merger took place which some say was sufficient to stave off the collapse of HBOS.

42. Brazil's competition authority, Conselho Administrativo de Defensa Economica (CADE), has had similar difficulties impressing the necessity of competition analysis in relation to mergers in the banking sector. The Central Bank of Brazil (BACEN) has long held jurisdiction and over the regulation of the sector and asserts control over bank mergers for similar public interest grounds of security of the financial system. Despite recent moves for increased cooperation between CADE and BACEN and increased involvement of CADE in the merger control process, BACEN remains the primary decision-maker about the viability of mergers.

43. The special characteristics of the financial sector could not, however, be dubbed a reason for the introduction by the Italian Government of ad hoc legislation to permit the Alitalia/AirOne merger. A decree was issued preventing the Italian antitrust agency from blocking a merger between the two air carrier companies and from blocking or imposing structural remedies in any mergers between large companies in crisis. This resulted in the clearance of a number of other potentially anti-competitive mergers, including the transaction through which Compagnia Aerea Italiana S.P.A. (CIA), a consortium of Italian private entrepreneurs, acquired the operating assets of Alitalia and sole control over AirOne.

44. Public interest overrides present the biggest challenge to competition authorities. Authorities will need to increase advocacy and lobbying activities to prevent wide spread implementation of such policies. Only time will tell of the full impact these overrides will have on competition but in any case they should be the exception rather than the rule if competition law is to be enforced effectively.

[9] Japanese and Chinese regimes do not explicitly provide for public interest overrides.

4. Remedies

45. In times of economic trouble, structural remedies, such as divestments, are less readily available owing, for example, to the reduction of potential acquirers on the market. There are a number of alternative options available where structural commitments cannot be imposed in the normal way. Authorities may prohibit the transaction altogether or require the merging parties to identify a buyer prior to completion. Alternatively, longer divestment periods may be granted. Authorities may also impose behavioural commitments provided these remedies actually address competition concerns. Finally, authorities may simply authorize the transaction without imposing conditions.

46. Whether to adopt one or a combination of these options has been decided on a case-by-case basis. In such difficult economic circumstances, the effective enforcement of competition will require flexibility and innovative thought from competition authorities, who must also do their best not to discourage harmless or economically beneficial mergers from occurring as a result of perceived or real difficulties in obtaining clearance.

D. Exit strategies

47. The exact effects of the compromises discussed above are difficult to predict. It is of paramount importance, however, that each merger approved under a more lenient application of the law should include a well thought out exit strategy to address potential distortions of competition. Pro-competitive exit strategies that were adopted during the crisis varied significantly across jurisdictions. Again, increased dialogue and cooperation between authorities may help to achieve a more streamlined approach and avoid potential international distortions in competition.

48. OECD suggested a number of pro-competitive policies and exit strategies that would reduce the distortive effects of State-backed, so-called “megamergers” in relation to the financial sector. These included the encouragement of international bank takeovers of domestic banks where domestic mergers pose a threat of increasing market power. In addition, OECD suggested that the impact on markets of anti-competitive mergers already in place can be mitigated by measures to promote new entry by, for example, reducing regulatory barriers to entry and limiting switching costs.

III. Competition advocacy

A. The need for an enhanced role

49. Competition advocacy has been defined as “activities conducted by the competition authority related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms, mainly through its relationships with other governmental entities and by increasing public awareness of the benefits of competition”. During the formative stages of a competition authority, competition advocacy is primarily used to inform stakeholders of the existence of the law and policy, and its associated obligations and rights. As time progresses, the role of competition advocacy changes, shifting towards generally advocating competition issues to government in the areas of privatization, sector regulation and other policies. During times of economic trouble, the role of competition advocacy must change and evolve further.

50. As mentioned above, mergers are often a composite part of wider regulatory and industrial policies aimed at achieving financial stability. This recession provided examples of government intervention that were potentially anti-competitive, such as the arrangement

of mergers or injection of financial stimulus to firms that went without competition analysis.[10] Unsatisfactory regulation of the banking sector can be said to be a major factor leading to the global recession. Unlike the relative objectivity proffered by competitive markets, regulation cannot always be trusted or relied upon for an effective outcome. This is compounded during recessions, when regulations are often reactionary and politically influenced. It is therefore essential that the impact on competition of such policies is fully assessed at inception so that other policy objectives are not achieved at the expense of competition. If competition law and policy is to be enforced effectively, competition advocacy must go beyond simply responding to merger applications and the application of competition law, but must advocate for greater access to the forums at which industrial policy decisions are made.

B. Competition-friendly industrial strategy

51. This being said, industrial policy should not be viewed as innately bad or unhelpful, particularly in times of economic troubles. The recession has now passed and it is widely acknowledged that, despite varying levels of success, State interventions and stimulus packages did prevent a more severe downturn and were instrumental to the recovery and current relative stability of the financial markets. It is therefore best to find a compromise between competition law and policy and industrial policy rather than focusing on the potential conflicts.

52. David Lewis suggests that competition authorities should identify elements of “competition-friendly industrial strategy” whilst concurrently advocating “against those elements of an industrial strategy that are most likely to engender severe market distortions”. Such an approach seems the most sensible and flexible means by which to balance the objectives of obtaining stability without jeopardizing the long-term objective of attaining growth and competitive markets.

C. Independence

53. These objectives should be achieved in a manner that does not compromise a level of independence of competition authority. The independence of competition authorities, and other sector regulators, reduces the potential for bias brought about by politicization and other potential conflicts of interest. It is vital that competition authorities are strong institutions that are not dependent on the current government in place but able to survive a change of political regime. Such independence is necessary to maximize the benefits of cooperation amongst competition authorities as it inspires greater confidence and trust in an authority’s judgement. Nonetheless, maintaining independence should be balanced with recognition that competition policy and merger control, in particular, operate in a broader context requiring competition authorities to coordinate and cooperate with government agencies.

D. Practical steps to widen the role of competition advocacy

54. Global competition regimes provide for varied opportunities for competition authorities to intervene in the development of industrial policy. Whilst some regimes allow authorities to issue ad hoc opinions on any subject, others expressly require that

[10] For example, the United States Government failed to consult the Federal Trade Commission about to the rescue plan for the automobile industry.

competition authorities are consulted whenever a regulation will potentially have an adverse effect on competition.[11] Some other regimes go further still, granting members of the competition authorities ministerial status and giving them the power to be intimately involved in formulation of industrial policies.[12]

55. In the absence of legal compulsion on governments to consult competition authorities on assistance plans and proposed mergers, it is all the more imperative for competition authorities to be proactive and intervene as far as they can in order to provide insight and views on competition implications to government bodies and the public at large. Greater coordination amongst competition regimes to make such measures more widespread would enhance the enforcement of competition worldwide.

56. In considering steps to widen the role of competition advocacy, it should first be noted that such actions should not be limited to periods of economic crisis but should be put in place and applied throughout the economic cycle in order to include within the regime enough flexibility to withstand difficult economic times. In response to the downturn, the United Kingdom Competition Commission suggested a number of crisis-specific competition advocacy strategies. These included, amongst others, first, the need for authorities to make know their stance and approach to enforcement during the crisis, advocating for the robust application of competition throughout all phases of the economic cycle with recognition of the practical effects of the economic situation in relation to resources and counterfactual analysis.

57. Second, competition advocacy should have as a priority waylaying unfounded concerns about the impact of competition policy such as the perception that it is at odds with recovery and stability. This can be achieved by contributing to ongoing debates and as far as possible publishing on specific issues. Third, as mentioned earlier, providing as much support and guidance to other regulatory bodies to ensure that the unintended anti-competitive consequences and costs are highlighted early. Fourth, providing additional guidance and clarification on policy in relation to specific matters would help to demonstrate how competition policy can contribute to resolving the crisis. Such guidance should highlight specific challenges that may arise and the proposed approach to deal with them.

58. To these very useful suggestions must be added some points highlighted earlier in the paper relating to advocating for the formulation of exit strategies for potentially anti-competitive mergers implemented as part of wider industrial strategies. In response to this crisis, competition authorities should do their best to influence the regulatory framework pertaining to the financial sector to lessen the preferential treatment afforded to banks and prevent a repeat of the “too big to fail” bailouts witnessed this time around. Competition advocacy should also include reviews of both industrial and competition policies in existence in order to learn from past experiences. Finally, advocacy should involve competition authorities entering into dialogue and exchange of best and relevant practices through Peer Review on competition law and policy in international forums.

IV. Conclusion

59. In an ever more open and interdependent world economy, effective enforcement requires the application of competition law and policy in the context of broader global

[11] The Spanish Government to Andalucía is one such example.

[12] This is the case in the Republic of Korea, where the head of the competition authority is a minister and participates in discussions of statutory texts or draft laws within the council of ministers.

cooperation. The advantage of free market economies is that all countries benefit from greater access to global markets. This enables dynamism, growth and economic development within national markets. It is therefore in the long-term interest of all nations that all or most countries have competition law and policy regimes in place and are equipped with the necessary expertise, resources and legal infrastructure to effectively implement them.

60. If global standards of competition policy and their enforcement are consistently high, everyone eventually benefits and the legitimacy of competition theory is enhanced. Worldwide cooperation between competition authorities in relation to enforcement therefore does not seek to pursue individual interests but to maximize the benefits of well-functioning markets that generate wealth for all. Coordination is crucial to achieve such cumulative global standards and legitimacy. Moreover, a lack of global cooperation and inconsistency in enforcement standards adds lustre to arguments against the effectiveness of competition as a tool for economic growth and development.

61. As with global tax fraud, corruption and terrorism, the effects of anti-competitive national policy can be felt beyond State borders. Effective enforcement of competition law and policy therefore requires conscious efforts on the part of national authorities to consider the broader global effects of their actions on competition. These objectives can only be achieved with a significant push to improve competition advocacy on the parts of competition agencies worldwide. Competition scrutiny must reach into all corners of government regulatory framework in order to limit the compromise of competition policy for the sake of conflicting policy objectives.

62. To these measures should be added a conscious effort to not only maintain existing standards of enforcement but make improvements as necessary and in line with global standards. This said, a realistic approach to enforcement in times of economic troubles necessitates taking account of the unique economic characteristics of a crisis period.

Questions for discussion

(a) Should merger control regimes consider the transnational effects of domestic mergers on competition in other States?

(b) How can coordination between competition authorities of developing countries and developed countries be encouraged?

(c) How can we achieve more global cooperation on the application of the failing firm defence?

(d) How can strong competition authorities that are able to withstand the influence of the current government in place be built?

(e) How can competition authorities gain more exposure to wider forums in which government policy decisions are made and avoid political capture?