

JOHANNESBURG 2009

RICHARD MURGATROYD

THE ECONOMICS OF THE FAILING FIRM DEFENCE

Session III: Merger Control: The Role of Economic Analysis
and Evidence in European Merger Control

Johannesburg 17th June 2009

OVERVIEW

- **Economics of merger control**
- **Economic underpinnings of the failing firm defence (FFD)**
- **FFD Guidelines in the EU/UK**
- **Case studies**
 1. **Kali und Salz**
 2. **BASF/Eurodiol/Pantochim**
 3. **Hypothetical (assets leave the market)**
- **Summary remarks**

ECONOMICS OF MERGER CONTROL

- Merger analysis compares post-merger outcome with relevant counterfactual
- In dynamic industries counterfactual required to account for dynamic factors e.g. innovation, entry, de-regulation
- Expected exit of an existing firm analogous to other dynamic factors- recognised in Iscor/Saldanha

ECONOMICS OF THE FFD

- Is there anything 'special' about failing firms?
- Not really, though procedural constraints may cause FFD to be examined with degree of separation
- Concern that assets leaving the market is a bad thing- BUT not always as we will see later
- Failing firms often give rise to other welfare/general equilibrium issues distinct from competition concerns

FFD GUIDELINES IN THE EU/UK

- Exact guidelines may vary but essentially 4 main principles
 1. Exit from the market is imminent
 2. Restructuring would not result in a different outcome
 3. No less anti-competitive purchaser
 4. If no less anti-competitive purchaser, no less anti-competitive outcome (EU version- assets would invariably exit the market)
- 1 + 2: Is the firm failing or merely flailing?
- 3 + 4: What is the relevant counterfactual?

CASE STUDY 1: KALI UND SALZ

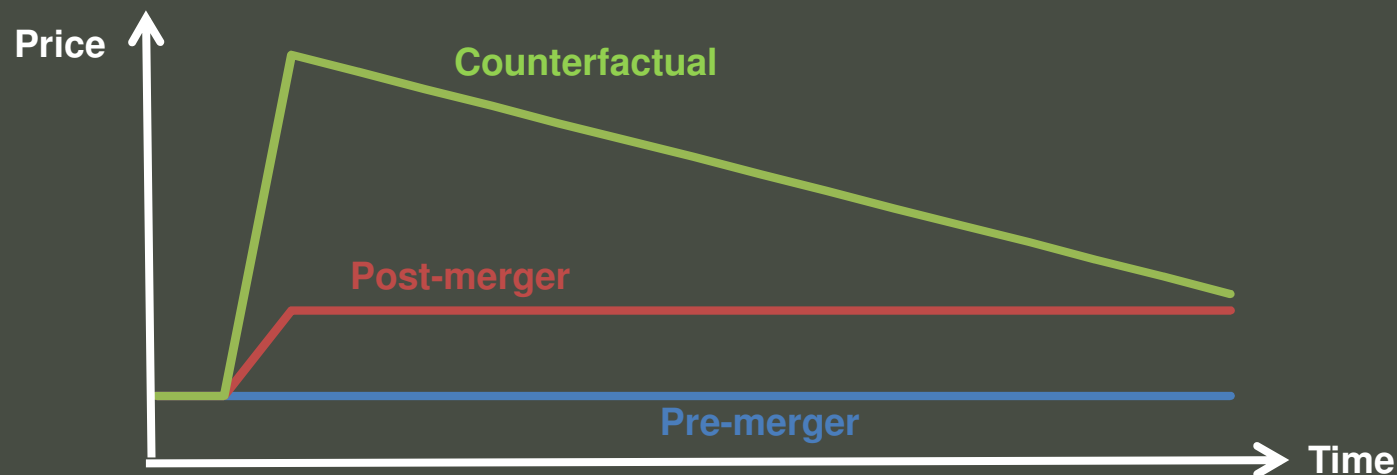
- K&S and MdK only two firms active in relevant market
- Acquisition of MdK by K&S would create *de facto* monopoly position for K&S
- Absent FFD- likely to give rise to an SLC
- CFI found if MdK exited K&S would face no competition and accrue entirety of market share
- **Post-merger outcome = counterfactual outcome**

CASE STUDY 2: BASF/EURODIOL/PANTOCHIM (1)

- Merger to combine two largest suppliers in the relevant markets
- Absent FFD- likely to give rise to an SLC
- European Commission found if Eurodiol exited BASF would still face competition from other suppliers
 - BASF likely to possess more market power (and market share) post-merger than under counterfactual
- Clear differences between this case and K&S

CASE STUDY 2: BASF/EURODIOL/PANTOCHIM (2)

- BUT exit of Eurodiol likely to create substantial shortage of capacity with limited prospects of entry/expansion- prices would rise



- Post merger outcome likely to be better (despite increase in market power) than counterfactual outcome

CASE STUDY 3: HYPOTHETICAL

- Merger between firms C and D
- Counterfactual: firm D to exit with demand re-distributed in line with remaining market shares

	Firm A	Firm B	Firm C	Firm D	HHI
Pre-merger	20.0%	20.0%	40.0%	20.0%	2800
Counterfactual	26.7%	26.7%	53.3%	0.0%	4267
Post-merger	20.0%	20.0%	60.0%	0.0%	4400

- Post-merger concentration higher than under counterfactual (is this better or worse?)
- Exit of assets from the market is not sufficient for FFD to hold

SUMMARY REMARKS

- Whether or not FFD holds is essentially an economic question that is already incorporated within the test for an SLC
- FFD guidelines are just that- not a substitute for substantive analysis
- EU case-law regularly departs substantially from guidelines
- **Key question: given a firm is failing, is the post-merger outcome better or worse than the counterfactual outcome?**