Milbank

Antitrust & Competition Group

Client Alert

The Failing Firm Defense in European Merger Control in Times of COVID-19 – A More Generous Approach?

9 December 2020

Key Contacts Antitrust

Dr. Alexander Rinne
Partner
+49 89.25559.3680
arinne@milbank.com

Dr. Moritz Lichtenegger
Senior Associate
+49 89.25559.3684
mlichtenegger@milbank.com

Susanne Schricker
Associate
+49 89.25559.3681
sschricker@milbank.com

The COVID-19 pandemic has unprecedentedly impacted economies throughout the world. Billions of Euros have been spent on measures of state aid to keep companies and whole industries alive. However, the dust is not yet settled. Many industries will need years to recover. Those that suffered the worst may seek a merger to survive. Others that weathered the pandemic crisis more successfully are likely to watch out for acquisition opportunities.

Against this background, voices are raised that call for a more lenient merger control treatment of transactions that involve firms in financial difficulties, including a more generous application of the failing firm defense. This client alert provides a summary of the European Commission's approach to the failing firm defense in its recent Flybe decision[1] and outlines potential prospects for the failing firm defense under the impact of COVID-19.

I. EU

1. The Flybe Decision

On 24 November 2020, the European Commission published its long-awaited decision concerning the acquisition of the UK regional air carrier Flybe by Connect Airways, a consortium of Virgin Atlantic, Stobart Aviation and Cyrus. While the acquisition was ultimately cleared with remedies[2], the European Commission expressly rejected the parties' arguments regarding the applicability of the failing firm defense, i.e. the argument that absent of the acquisition by Connect Airways, Flybe would become insolvent and exit the market in any event so that the market structure and competitive situation would be the same with or without the transaction.

---

1 European Commission, decision dated 5 July 2019 (published on 24 November 2020), Case M.9287 – *Connect Airways / Flybe*.

2 To address the competition concerns identified by the European Commission, Connect Airways committed to release five daily slot pairs at Amsterdam Schiphol airport and three daily slot pairs at Paris Charles de Gaulle airport to competing airlines that want to fly the Birmingham - Amsterdam and Birmingham - Paris routes.

Under the European Commission's Horizontal Merger Guidelines[3] and the respective case law of the European Court of Justice[4], the European Commission is entitled to decide that an otherwise problematic merger can nevertheless be cleared if three cumulative criteria are met:

1. 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.

2. There is no alternative purchaser that would cause less competition concerns.

3. In the absence of a merger, the assets of the failing firm would inevitably exit the market.

In the Flybe case, there had not been any other formal offers for Flybe's assets so that apparently the second requirement was met. However, the European Commission found that neither the first nor the third requirement were met since the parties failed to provide sufficient evidence that absent the proposed acquisition Flybe and its assets would have exited the market completely and entirely. In particular, given the essential importance of take-off and landing slots for airline operations and the shortage of slots at the respective airports, the European Commission concluded that at least parts of Flybe's assets – the slots – would likely be reallocated to other airlines under the European Slot Regulation[5] so that they could be used at least partially on the routes previously offered by Flybe.

2. Impact of COVID-19

The publication of the Flybe decision facilitates the discussions regarding a more lenient application of the failing firm defense in merger control proceedings and raises the question whether the European Commission would have decided differently against the background of the COVID-19 pandemic. However, Margrethe Vestager, the European Commission's Vice President and Competition Commissioner, was quick in excluding already in April 2020 a more permissive approach regarding the failing firm defense, warning that the pandemic

> *"shouldn't be a shield to allow mergers that would hurt consumers and hold back the recovery."*

At the Fordham Annual International Antitrust Law and Policy Conference on 8 October 2020 she confirmed and reiterated her strict approach:

> *"The crisis may also form the background for more recourse to the 'failing firm' defense, in cases where companies buy weakened rivals. That makes our criteria in this area more important than ever – the failing firm's future in the market; the availability of other options that harm competition less; and the final fate of the assets if the firm were to fail. Any departure from these criteria would mean falling into the trap of allowing the crisis to lead us away from our objective, which is to preserve open and competitive markets."*

In essence, even if the pandemic crisis will result in an increasing number of mergers that involve firms in financial difficulties, the European Commission – at least for the time being – intends to maintain its strict approach to the failing firm defense.

---

3 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentration between undertakings (the "**Horizontal Merger Guidelines**"), OJ C 31, 5 February 2004, paras. 89-91.

4 European Court of Justice, judgment dated 31 March 1998, Joined Cases C-68/94 and C-30/95 – *Kali & Salz*.

5 Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports (the "**Slot Regulation**"), OJ L 14, 22 January 1993, p. 1.

II. Selected EU Member States

While the European Commission claims to leave its strict approach untouched, this has not remained unchallenged across EU Member States:

- During the first peak of the pandemic crisis, the UK Competition and Markets Authority ("**CMA**") provisionally cleared Amazon's investment in Deliveroo, arguing that an exit of the food delivery company from the market would be worse for competition than allowing the Amazon investment to proceed. However, following strong criticism the CMA amended its provisional decision to conclude that Deliveroo was no longer likely to exit the market without the transaction and, thus, still cleared the transaction without having recourse to the failing firm defense.[6]

- In September 2020, Cani Fernández, the head of Spain's National Commission of Markets and Competition ("**CNMC**"), openly questioned whether the failing firm defense should be interpreted that strictly. In her view, if interpreted more generously the failing firm defense could play an active role in coping with the challenges of the COVID-19 pandemic. However, she also pointed to the importance of a common understanding of the failing firm defense throughout the EU to avoid inconsistent decisions.[7]

- In Germany, Andreas Mundt, the head of the German Federal Cartel Office ("**FCO**"), most recently left it open whether the failing firm defense should be interpreted more generously. Instead, he referred to the fact that the number of failing firm mergers notified has not yet risen since the inception of the COVID-19 pandemic due to the temporary suspension of the companies' obligation to file for insolvency. While he agreed that the FCO will probably see more notifications of failing firm mergers once the temporary suspension lapses, he is of the opinion that this will not automatically lead to a broader application of the failing firm defense but rather to higher time pressure during the review procedure.[8]

III. Key Takeaways

To date, the European Commission has only accepted the failing firm defense in three cases.[9] Based on the European Commission's Flybe decision and recent public statements of leading European Commission officials, it is likely that companies will continue to face high standards of proof to invoke the failing firm defense in merger control proceedings irrespective of the devastating impact of the COVID-19 pandemic.

However, in light of the devastating impact of the COVID-19 pandemic on competition in entire sectors or industries, it remains to be seen whether the European Commission can maintain its strict approach against the increasing political pressure particularly from the EU Member States. It might well be that the European Commission will have to find ways to take greater account of the prevailing market conditions when applying and enforcing competition laws to industries particularly impacted by the COVID-19 pandemic. The European Commission could, for example, fine-tune its tools by taking recourse to one of the following policy options:

---

6 UK Competition and Markets Authority, decisions dated 17 April and 4 August 2020, Case ME/6836/19 – *Amazon / Deliveroo*.

7 Cani Fernández at the EU Competition Day on 8 September 2020.

8 Andreas Mundt at the Arbeitstagung Studienvereinigung Kartellrecht on 3 December 2020.

9 European Commission, decision dated 9 July 1998, Case M.308 – *Kali & Salz / Mdk / Treuhand*; decision dated 11 July 2001, Case M.2314 – *BASF / Eurodiol / Pantochim*; decision dated 9 October 2013, Case M.6796 – *Aegean / Olympic II*.

- One option would be to temporarily soften the criteria for a failing firm defense as a result of a changing economic environment due to the COVID-19 pandemic either by way of changing its actual merger enforcement practice or by issuing official communications or guidelines similarly to the Temporary Framework for State Aid Measures.[10]

- In order to better reflect the prevailing market conditions, one could also think of introducing a new "weakened competitiveness defense" alongside the traditional failing firm defense. Such a weakened competitiveness defense could deal with cases where a financially distressed company's competitive significance is likely to decline going forward, but where the company or its material assets may not go out of business entirely. In such a situation, a weakened competitiveness defense could open up the room for weighing the procompetitive benefits of a transaction against any anticompetitive harms.

---

10 Communication from the Commission, Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (the "**Temporary Framework for State Aid Measures**"), OJ C 91, 20 March 2020, p. 1, as amended on 3 April, 8 May, 29 June and 13 October 2020.

Antitrust Group

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any member of our Antitrust Group.