

**Response to the  
Competition Commission and the Office of Fair Trading**

***Merger Assessment Guidelines  
Consultation Document, April 2009***

**20 August 2009**

**ALLEN & OVERY**

**ALLEN & OVERY LLP  
LONDON**

## 1. EXECUTIVE SUMMARY

- 1.1 We welcome this opportunity to comment on the Competition Commission (CC) and the Office of Fair Trading's (the OFT's) April 2009 joint consultation document *Merger Assessment Guidelines* (the **Draft Guidelines**). These comments follow the useful session we had with representatives of the OFT and CC on 17 July 2009.
- 1.2 In general we support the publication of joint guidelines by the CC and OFT. Although there are instances (detailed below) where we think the Draft Guidelines would benefit from further clarity as to the differences in approach between OFT and CC, we consider it helpful to capture the approach of both authorities in a single document.
- 1.3 Our specific comments and suggestions on the Draft Guidelines are set out in more detail in the sections that follow.

## 2. INTRODUCTION

- 2.1 Paragraph 1.5 states that the OFT and the CC will apply the guidance flexibly and may depart from it. While we completely recognise the need to apply the guidance flexibly, we do not consider it appropriate for the OFT and CC to envisage a departure from the adopted guidance, in any event without providing a compelling justification. Business and advisers rely upon the OFT and CC following their own guidance in making important commercial decisions, and decisions inconsistent with guidance risk an unattractive level of uncertainty for business inconsistent with the approach in Brussels (under EC case law, the Commission is bound by its guidance).
- 2.2 Paragraph 2.5 explains that, in exercising its judgement on whether there is a realistic prospect of an SLC, the OFT will take into account the potential adverse impact on consumer welfare of an incorrect decision not to refer. This could suggest that the OFT's threshold of belief may vary according to the markets under consideration or other circumstances of the case. We would welcome further clarification as to whether the OFT will lower the reference threshold for large consumer markets and, therefore, whether the same fact pattern could give rise to an OFT reference if it were a retail market but a clearance if it were an upstream market. It would also be helpful if the guidance were to comment on whether retail markets attract a different approach because any adverse effects apply directly to consumers, and whether the analysis in *BSkyB/ITV* (TV market) and *Lloyds/HBOS* (mortgage market) is particularly case-specific. More generally, it would help if the OFT made clear that the high-profile nature of a case would not, in itself, be a relevant factor in the formation of the OFT's belief in favour of reference.

## 3. THE RELEVANT MERGER SITUATION

### ▪ *Material Influence*

- 3.1 We would welcome clarification of the view and approach that the CC would take on the factors set out in the OFT's June 2009 jurisdictional and procedural guidance, taking into account the fact that the CC's view in relation to these matters is determinative.<sup>1</sup>

### ▪ *The turnover test*

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<sup>1</sup> In relation to completed mergers, section 35(1)(a) of the Enterprise Act 2002 (the Act) requires the CC to decide whether a relevant merger situation "has been created". Similarly, in relation to anticipated mergers, section 36(1)(a) of the Act requires the CC to decide whether a relevant merger situation "will result". In comparison, when considering whether it is under a duty to make a reference to the CC, the OFT must determine if it "believes that it is or may be the case that" a relevant merger situation has been created (section 22(1) of the Act with respect to completed mergers) or will result (section 33(1) of the Act with respect to anticipated mergers).

3.2 We welcome the clarification provided by paragraph 3.27 that, when considering the turnover test, the turnover in question is simply the turnover of the target(s) in the UK.

#### 4. A SUBSTANTIAL LESSENING OF COMPETITION

4.1 Part 4 of the Draft Guidelines is long and difficult to navigate. We suggest that the structure of this section could be improved.

- *Theories of harm*

4.2 As raised in the session on 17 July, we consider that paragraph 4.13 is flawed. In particular we have concerns with the statement "the Authorities may not need to form a view on the likelihood of both theories of harm if they expect one of them to be sufficient to meet their respective competition test". If two theories of harm are mutually exclusive, the CC will need to form a view given that it must apply a balance of probabilities/more likely than not standard. In addition, we consider it desirable that the OFT should in principle form a view as to whether the theories of harm in question are "more likely than not" to arise rather than just meeting the "realistic prospect" test (for de minimis purposes, but also generally).

4.3 In the same vein, we consider that paragraph 4.14 should be amended so that it is clear that "adding up" probabilities to make an overall SLC assessment is not legally valid both generally and, in particular, when the two outcomes are mutually incompatible. If the OFT cannot satisfy itself of even a realistic prospect of any one of unilateral, coordinated or non-horizontal effects, respectively, it is clearly not possible to say that, "in the round", there is a realistic prospect of at least one of them. It is a different matter (and common practice) to conclude the reference test is met on one theory, while leaving the question open on other theories.

- *The counterfactual*

4.4 Generally, we would like to see the difference in approach of the authorities to the counterfactual clarified. It could be made clearer that the OFT compares the merger with the "most competitive realistic" counterfactual (paragraph 4.21) but that the CC compares the merger with the "most likely" alternative outcome (paragraph 4.25). These clarifications should be followed through in the section on the failing firm defence, and in particular in paragraph 4.33.

4.5 We think it is unattractive to conclude that a counterfactual cannot be constructed taking into account a pre-merger cartel. If the latter is a fact it would be irrational to ignore an obviously relevant fact. The policy concern (that the Authorities will not countenance arguments that the merger cannot make collusive conditions worse than a prevailing cartel price) is best dealt with by concluding that, absent the merger, the cartel will break down or be broken up. The merger can then be assessed against this counterfactual by examining whether it would hinder the breakdown of the cartel by making it more stable, widespread or stronger (or allow for tacit collusion persisting after the cartel has been broken up; see the empirical literature on post-cartel vitamins pricing).

4.6 We consider that paragraphs 4.35 to 4.39 on competing bids are confusing and unnecessarily complicate the OFT/CC's approach. The message could be more succinctly put that generally the counterfactual will be the prevailing conditions of competition.

4.7 We consider that the use of the wording "whether or not" in paragraph 4.41 is misleading. It could mean that the OFT will consider the statutory test against the scenario of the parallel transaction proceeding as well as against the scenario of the parallel transaction not proceeding. Alternatively, it could mean that the OFT will consider the statutory test "regardless of" the parallel transaction proceeding.

4.8 The approach to parallel transactions set out in the Draft Guidelines (paragraphs 4.40-42) could result in the referral of two transactions when either alone would not give rise to an SLC. Such an outcome is unattractive, and should be avoided wherever possible (as indeed was done in respect of *Capita/IBS* and *Northgate/Anite*). Nevertheless, in the scenarios where this is unavoidable – the 4 to 3 merger is cleared and the 3 to 2 merger is an SLC and the question is which merger is which – it would in our view be far preferable if the guidance were to deal with this now, in the abstract, rather than waiting and having to decide which merger is which in the heat of two live cases. The problem does not become easier if postponed to a live setting where either set of parties would have good grounds to litigate the matter and neither of the four merging parties could use the guidance, in current form, to predict the Authorities' approach.

- ***Horizontal mergers – unilateral effects***

4.9 We suggest that the "demand withholding" argument in paragraph 4.111 is clarified.

- ***Horizontal mergers – coordinated effects***

4.10 As a general point in relation to paragraphs 4.115 to 4.132, we suggest that it is clarified that the conditions for tacit and explicit coordination differ. For example, tacit coordination can only occur where there is a sufficiently transparent reference point around which participants can reach an understanding and a mechanism suitable for reaching such an understanding (e.g. repeated interactions). By contrast, explicit price-fixing resolves this problem by direct communication between the participants. Further, tacit coordination can only emerge where the coordinated outcome is profitable for the participants, but price-fixers can resolve the issue of different incentives by (for example) financially compensating those who lose out through side-payments.

4.11 We consider that it should be clarified in paragraph 4.120 that past explicit collusion is ambiguous as an indicator that tacit collusion is likely; it can be a plus-factor (incentives to coordinate are present), it can also show that only by explicit collusion could the firms reach terms and monitor and enforce them (ability to coordinate tacitly is not present).

4.12 In discussing the likelihood of explicit collusion it would be helpful to make clear that the Authorities will take into account: (i) the disincentive provided by potential enforcement action; and (ii) the likelihood that the conduct will actually be discovered and stopped. This would mirror the approach relating to Article 82/Chapter II (see *EWS/Marcroft*). Paragraph 4.116 seems to suggest this, but without making any commitment (in contrast to paragraph 4.167).

4.13 We have concerns with the final sentence in paragraph 4.122 which states that "a merger that results in a market with two or three similarly sized firms, in which the three conditions for coordination are met, may well be considered to give rise to an SLC on the basis of coordinated effects". The conditions for coordination are necessary, but they are not sufficient. The use of "may well" is unclear.

- ***Non-horizontal mergers***

4.14 We consider that the section on customer foreclosure in vertical mergers (paragraph 4.146) should clarify that customer foreclosure could apply to a situation where the downstream subsidiary of the merged entity is either a distributor, preventing access of upstream rivals to important downstream customers, or the important customer itself.

4.15 We consider that footnote 92 should note that whilst the argument in relation to vertical mergers allowing access to non-integrated rivals' commercially sensitive information (set out in paragraph 4.151) was raised in *BSkyB/ITV*, it was not relied on and was ultimately dismissed.

- 4.16 Paragraph 4.168 of the Draft Guidelines covers diagonal mergers. However, as currently drafted, the example describes a purely horizontal merger between downstream rivals. As mentioned during the session on 17 July, we suggest the example is changed to describe an acquisition by an upstream firm that supplies an input to an independent downstream entity of a rival of that downstream entity that does not use the input, i.e. to clarify that the merging parties are present at different stages in two production processes used to make the same end product.
- 4.17 The electricity market provides an illustrative example. Electricity may be generated using different fuel sources including coal and gas. If a producer of coal buys a gas-fired power station, it may have the incentive to increase its coal price to independent coal-fired generators, if this will result in increased output from its gas-fired power stations.
- ***Efficiencies***
- 4.18 We consider that the text in the first bullet point of paragraph 4.204 (conditions for efficiencies) should state "Efficiencies must be demonstrated to be likely to arise," rather than "Efficiencies must be demonstrated to be very likely to arise". The *evidentiary* burden should of course be such to reflect information asymmetries and so forth, but the *standard of belief* should be neutral as to whether merger effects are pro- or anti-competitive: at Phase II in any event, the same standard of proof should be applied to efficiencies claims as is applied for an SLC finding. Parties should not be required to rebut a probability with a certainty. For efficiencies at the OFT stage, *Global/GCap* is conspicuous by its absence from the footnotes: the guidance should refer to it or, if no longer considered to capture current OFT thinking, explain in which respects it will and will not be a useful future precedent, specifically on the "sliding scale" methodology applied to SLC findings and efficiencies (and in this sense familiar from the more frequently employed de minimis exception.),

**Allen & Overy LLP**