Mergers – Exceptions to the duty to refer and undertakings in lieu Draft guidance consultation document

Comments from Alistair Lindsay[1]

1. Introduction

1.1 I welcome the opportunity to provide comments on the draft guidance consultation document, "Mergers – Exceptions to the duty to refer and undertakings in lieu" ("**the draft Guidance**").

1.2 The draft Guidance contains a great deal of very valuable material. In particular, it usefully updates the *de minimis* section, where the OFT's decisions had diverged significantly from the existing guidance, and addresses some of the controversial issues that have arisen with undertakings in lieu, especially confirming that undertakings in lieu may resolve a case even if there are doubts over the precise nature or likelihood of the substantial lessening of competition.

1.3 This response comprises four main points (set out in section 2 below), some minor points (section 3) and a response to the specific questions identified by the OFT (an Annex).

1.4 It does not contain any information relating to the private affairs of an individual or confidential commercial information relating to a business.

2. Main points arising from the draft Guidance

2.1 The first two issues relate to the operation of the size of market(s) thresholds in operating the *de minimis* exception. For convenience, the approach proposed in the draft Guidance is summarised in Table 1 below.

Table 1: Summary of the approach proposed in the draft Guidance to the operation of the size of market(s) thresholds

Size of market(s)	OFT approach in the draft Guidance (assuming no "clear-cut" undertakings in lieu)
>£10m	"Generally" refer (§2.2). If market size(s) "only marginally exceeds" £10m, the OFT may consider applying the *de minimis* exception, but the exception will be applied only if the case is "extremely 'marginal'" (fn. 13).
£6-£10m	The OFT will consider applying the exception (§2.2), but fn. 6 cites *Eastbourne*: the OFT is "unlikely" to apply exception to a £6m market unless other factors "strongly suggest it should do so".
£3-£6m	The OFT will consider applying the exception (§2.2).

[1] Dr Alistair Lindsay is a barrister practising from Monckton Chambers. He is the author of "The EC Merger Regulation: Substantive Issues", a third edition of which was published in October 2009 (co-authored with Alison Berridge). He was a partner in Allen & Overy LLP from May 2001 until February 2009. The comments made in this response are wholly personal and do not reflect the views of any other members of Monckton Chambers or any clients.

<£3m	The OFT will generally apply the exception (§2.14), but particular facts may result in a reference.

<u>(a) The £10m threshold is set at too low a level</u>

2.2 This section argues that the £10 million threshold used in the draft Guidance for the application of the *de minimis* exception is set at too low a level. There are two reasons for believing that a higher threshold should be used.

(a) The first is that the draft Guidance contemplates that the *de minimis* exception operates as part of a broad cost/benefit analysis, where the relevant "costs" of a reference comprise the average cost to the public purse of a CC reference. This seems an unduly narrow measure of the "costs" of a reference, measured from the perspective of consumer welfare. In particular:

(i) a reference involves a huge amount of management time; it is reasonable to assume that management is reasonably effective and that part of its focus in the normal course of business is on improving the quality of the goods or services provided; if so, it follows that diverting management time to a material extent away from the business causes some harm to consumers;

(ii) a reference delays implementation of the transaction; leaving to one side transactions that are motivated solely by the pursuit of market power (which ought to be excluded from the *de minimis* exception by the deterrence criterion), mergers generally produce some efficiencies, some of which operate to benefit consumers (and, of course, it is the existence of such efficiencies which explains why mergers are treated more benignly than price fixing arrangements between competitors); delaying the transaction[2] deprives consumers of some of those efficiencies, or at least delays them;

(iii) a reference is notoriously time consuming and uncertain and experience suggests that the process of going through a reference generally damages one or both of the businesses, as customers and/or key employees switch to other, more stable options; a customer who switches supplier because of the uncertainty arising from a reference suffers harm from the reference because, in the absence of the uncertainty, the merging party was the more attractive supplier; in addition, if the business is damaged as a result of the loss of key employees, this is likely to harm consumers;

(iv) a reference involves significant private costs; these are of course paid by the merging parties and therefore on their face impact on producer welfare, and not consumer welfare; however, in practice it is difficult to believe that the imposition of very significant costs (compared with the size of the market) does not in any way alter the merging parties' pricing incentives; if prices are raised, even by a little, in order to take account of those costs, then there is a harm to consumers.

---

[2] Whether the delay arises because of the terms of the sale contract (or the conditions of a public offer) or as a result of hold separate undertakings or orders.

Items (i) to (iv) above are not generally capable of quantification, but they are non-trivial factors (and, moreover, are factors that are relevant to those consumers who might be harmed if the merger gives rise to a substantial lessening of competition[3]) which, applying the OFT's methodology, increase the "costs" of a reference and ought therefore to point towards raising the threshold. In paragraph 2.7 of the draft Guidance the OFT states that its focus on public costs arises not only because of its focus on consumer welfare, but also "in the case of merger control, parties have a clear choice as to whether to pursue a potentially anti-competitive transaction and are also able to structure transactions so as to reduce the merger control risk that they assume." However, this argument does not justify excluding from the analysis the costs identified in sub-paragraphs (i) to (iv) above because those costs are suffered by consumers, and not the parties to the merger.

(b) The second is that the statute refers to the "market ... or ... markets" not being of sufficient importance to justify a reference. However, in paragraph 2.30 of the draft Guidance, the OFT contemplates that the size of the market might be adjusted when it is clear that "the size of any consumer detriment will be experienced only by a subset of the overall market". This reflects a series of decisions.[4] The approach in the draft Guidance is logical and consistent with the idea underlying the *de minimis* exception because it focuses on balancing the costs of the reference with the likely consumer harm. However, it is not straightforward to square with the focus on the "market ... or ... markets" in the statute, and it would be better to carry out a straightforward calculation of market size and draft revised guidance using a higher threshold, whilst making it clear that markets approaching this size would be candidates for the *de minimis* exception only in exceptional circumstances (e.g. if the potential consumer harm was very limited or was focused on limited parts of the market).

<u>(b) Introducing a £6m intermediate threshold is unhelpful</u>

2.3 In footnote 6, the draft Guidance refers to *Stagecoach / Eastbourne Buses and Cavendish Motor Services* and quotes the decision as stating[5]: "[t]he OFT has not previously applied the de minimis exception in markets of [in the region of £6 million] and notes it will be unlikely to do so unless its assessment of the other relevant factors strongly suggest it should do so". Of course, in one sense, this footnote is entirely unobjectionable as it does no more than refer to an existing OFT decision. However, the passage quoted was not necessary for the OFT to reach its decision in *Eastbourne*, yet by choosing to repeat the paragraph in the draft Guidance the OFT implies that it intends to apply the indication given in *Eastbourne* in future cases. If it does, this introduces four market size(s) bands, as shown in Table 1 above. The draft Guidance explains that the exception is intended to involve a cost/benefit assessment taking the costs of the reference and weighing them against the potential benefits of prohibiting or otherwise limiting the merger, taking account of how bad the harm caused by the merger might be (which is a function of the market size, the

---

3 In contrast to the costs of a CC reference which are borne by consumers generally in their capacity as taxpayers.

4 See, e.g., *Govia Ltd / South Central Passenger Rail Franchise*, para. 66 (excluding revenue from regulated rail fares because the consumer detriment that may arise as a result of the merger involved unregulated rail fares or bus fares), *National Express / East Coast* (exclusion of rail services), *FMC / ISP* (exclusion of a powerful buyer, Reckitt Benckiser) and *Orbital / Ocean Park* (exclusion of two powerful buyers; para. 77).

5 Paragraph 76.

magnitude of competition lost by the merger, and the durability of the merger's impact) and how likely that harm is to arise. This weighing exercise involves a number of factors and it seems to me unduly restrictive to pick on one of them (market size) and introduce an intermediate threshold at £6 million. It would be better simply to say that the larger the market size, the more compelling the other factors must be if a reference is to be avoided.

(c) The draft Guidance is not sufficiently clear on when *Dunfermline* will prevent the *de minimis* exception applying

2.4 The draft Guidance is unclear on whether the *de minimis* exception will be available when undertakings in lieu could be offered that fall short of selling off the entire business of one of the parties but go beyond the sale of one of the parties' activities in the market or markets where competition problems have been identified.

2.5 As explained in response to Question 4 in the Annex, it is not clear how the OFT will proceed if undertakings in lieu could be offered that involve the divestment of more than the activities that create the competition concern (i.e. the undertakings are not precisely tailored to the competition concern) but fall short of the divestment of the entirety of one of the parties' activities. For example, if the competition concern arises in market A, the target's activities[6] in market A are inextricably interlinked with its activities in market B and the target is also active in unrelated markets C and D, then clear-cut undertakings in lieu are available, namely the divestment of the target's activities in markets A and B and such a divestment would not be tantamount to a prohibition. Paragraph 2.27 and footnote 11 of the draft Guidance explain that the OFT will take a "conservative approach" to questions of this type and, referring to *Capita / IBS*, state: "To the extent that there is any doubt as to whether an undertaking would meet the 'clear-cut' standard, it will not be included in the 'in principle' assessment." This sentence appears to direct the reader to the discussion at paragraphs 5.9 to 5.13 of the draft Guidance of the "clear-cut" standard in assessing undertakings in lieu. However, applying those paragraphs to the example given, it is clear that a divestment of A and B (or indeed, A, B and either or both of C and D) would meet the "clear-cut" standard.

2.6 Nevertheless, in two cases that were decided after *Capital / IBS* but are not referred to in the draft Guidance, the OFT did not rule out the *de minimis* exception at this first stage when there were links between the parties' activities in the markets giving rise to competition concerns and the parties' other activities, so that it was not possible to offer a "clear-cut" divestment remedy *that was precisely tailored to the competition problem*.[7] In each of the cases, the activities creating the competition concern *and* the connected activities taken together did not comprise the entirety of one of the merging parties' businesses, so "clear-cut" undertakings were available to resolve the competition concerns that would *not* have amounted to a prohibition.

---

[6] And the purchaser's.

[7] In *Seniorlink Eldercare / Aid Call*, 21 July 2009, the competition concern involved one element of the parties' activities (the provision of pendant alarms) in Northern Ireland. The OFT found, at para. 95, that a structural remedy would not be effective because the parties' businesses in Northern Ireland were not stand alone and instead were connected with their British businesses. The merging parties' activities extended beyond the supply of pendant alarms. Similarly, in *Spectris plc / Lochard Ltd*, 29 January 2009, para. 116, the OFT found that there were links between the parties' activities in the area creating competition concerns and their other activities (although a divestment of the problematic and linked businesses would not have amounted to a prohibition). See also *Prince Minerals Ltd / Castle Colours Ltd*, 6 May 2009, para. 57.

2.7 I suggest that the OFT should apply a proportionality test: if the putative clear-cut undertakings would be proportionate to the competition concerns identified (e.g. because they are precisely or broadly tailored to the competition problem) then the *de minimis* exception is not available. However, the exception is still available if any clear-cut undertakings would be disproportionate, e.g. amounting to a prohibition or involving the sale of extensive connected businesses. It would be useful to amend the draft Guidance to make this clear as the reference to adopting a "conservative approach" to the "clear-cut" standard does not seem properly to capture the issues that the OFT is, and should be, considering in analysing this issue.

(d) The "upfront buyer" mechanism seems inconsistent with Parliament's intention, and involves an unduly demanding standard

2.8 The OFT has developed the "upfront buyer" mechanism because[8] it is concerned that it does not have power to refer the case to the CC if undertakings in lieu are not complied with. There are two reasons to believe that this development is erroneous.

(a) The undertakings in lieu provisions were present in the Fair Trading Act 1973, and did not provide for a reference to be made to the CC if the undertakings were breached. At the time that the Enterprise Act 2002 was passed, the OFT had not developed the "upfront buyer" mechanism. If Parliament had been concerned that the OFT lacked the power to make a reference to the CC if undertakings were breached, Parliament could have given the OFT such powers in the Act. It did not, and the inference is that Parliament regarded as sufficient the powers that were given to the OFT in the case of breach of undertakings in lieu.

(b) In fact, the powers that the OFT has in the case of breach of undertakings in lieu are sufficient, without the need to make a reference to the CC. Parliament has, through section 75(4) given the OFT the very wide order-marking powers under Schedule 8. (Indeed, the OFT's order making powers are identical to those given to the CC following a reference.[9]) For example, if a company undertook to sell to sell business A within a specified period and failed to do so, then the OFT could use its Schedule 8 powers to order the sale of businesses A+B (if the addition of a further business, B, was regarded as likely to attract buyers) or the sale of a different business, C (which might be, for example, the purchaser's business that competes with the target's business, A).

2.9 Moreover, the threshold for avoiding an upfront buyer remedy (namely that the parties can rule out any doubts about the availability of suitable purchasers) is set at a very high level, meaning that upfront buyer mechanisms will increasingly be used. However, when the OFT makes a decision to clear a transaction subject to undertakings involving an upfront buyer, this extends the already lengthy UK phase 1 (and, potentially, phase 2) timetables. It can be difficult to accommodate such lengthy timetables into public bids and private sales agreements.[10]

---

[8] See paras 5.35 and 5.36 of the draft Guidance.

[9] See s. 84(2).

[10] I recognise, of course, the scope for the parties to draft their offer conditions or sale and purchase agreements in terms taking account of the nuances of the OFT's approach to this issue.

3. Minor points arising from the draft Guidance

3.1 In paragraph 2.1, the draft Guidance states, "The exception is designed primarily to avoid references being made where the costs involved would be disproportionate to the size of the market(s) concerned." The reference to "primarily" implies that there are, or may be, secondary or subsidiary objectives. If the OFT believes that there are, or may be, such objectives, it would be useful to say so and explain what they are, so that interested parties can understand the other circumstances in which the exception might be available.

3.2 Footnote 5 of the draft Guidance provides an illustrative scenario that might justify the choice of a £10 million threshold. The footnote states that the facts "should not be read as precedential in respect to any individual criterion". However, it assumes that the merger will lead to a 5 per cent. price increase for two years and, implicitly, contemplates that after two years prices will return to the level that would have prevailed in the absence of the merger. The example implies that, in the absence of the *de minimis* exception, the merger in question would be referred to the CC. Although the scenario was clearly chosen in order to illustrate the cost/benefit analysis that arises when applying the *de minimis* exception, it is interesting to note that the consumer harm was limited to two years. If the harm was expected to last for only two years because new entry was timely (applying the normal, but not invariable, two year horizon), likely and sufficient to counteract the harm to competition arising from the merger, then, applying the draft Merger Assessment Guidelines,[11] the case ought to have been approved by the OFT in any event. Equally, if the harm was expected to last for only two years for some reason other than new entry, then the case ought equally to have been approved by the OFT in any event since two mergers that have an identical impact on consumers ought not to be treated differently because of the label attached by merger control practitioners to the reason why consumers are not harmed (of course, if the label does matter, then the UK merger control system needs to be reviewed as it lacks systemic coherence).

3.3 Footnote 74 of the draft Guidance states: "The OFT will normally require the selling party to require from the divestment purchaser a warranty reflecting [the obligation that the purchaser has the financial resources, expertise (including managerial, operational and technical capability), incentive and intention to maintain and operate the relevant business as part of a viable and active business in competition with the merged party and other competitors in the relevant market], or a variant of it, in its sale and purchase documentation". It seems to me that there is probably no mechanism for enforcing such a warranty and it is bad practice to place weight on a "commitment" that ultimately cannot be enforced. A claim for a breach of a warranty would be one for damages and the recipient of the warranty (i.e. the vendor of the divestment business)[12] would generally not suffer any loss if the purchaser were in breach of the warranty (e.g. because it never intended to compete with the vendor): in divestments to address horizontal overlaps, the vendor will generally benefit if the purchaser competes less effectively than envisaged. (See also the response to Question 22 of the OFT's questions in the Annex.)

Alistair Lindsay
Monckton Chambers
29 October, 2009

---

[11] See paragraphs 4.186 to 4.189.

[12] It is doubtful whether the OFT would be able to enforce under the Contracts (Rights of Third Parties) Act 1999.

ANNEX: RESPONSE TO THE OFT'S QUESTIONS

This Annex sets out the OFT's questions in bold and the responses in normal type.

Questions about markets of insufficient importance

Q1 Do you agree that assessing whether to exercise the 'de minimis' discretion on the basis of a broad brush cost/benefit approach is a reasonable approach to this discretion?

Yes.

Q2 Do you agree that the OFT should only take account of public – and not private – costs in considering the cost of a reference, given that it generally takes decisions based on a consumer – and not total – welfare basis?

I agree that the OFT should focus exclusively on consumer welfare and should disregard costs that are shouldered exclusively by producers. However, it seems unduly narrow to treat the costs of the CC reference as the only "costs" forming part of the cost/benefit analysis. In particular, the merged group's customers incur costs as a result of a reference for the reasons given in section 2(a) of the main response. Indeed, those costs seem especially important, since they are incurred by the merged group's customers, rather than the public as a whole.

Q3 Do you agree that the OFT's Dunfermline Press policy position with respect to the proportionality of a reference where undertakings in lieu are available is a reasonable one?

Yes.

Q4 Is it clear what the OFT means when it refers to undertakings in lieu being 'in principle' available in the context of de minimis? If not, what further guidance would be useful?

As the draft guidance stands, it is not clear how the OFT will proceed if undertakings in lieu could be offered that involve the divestment of more than the activities that create the competition concern (i.e. are not precisely tailored to the competition concern) but fall short of the divestment of the entirety of one of the parties' activities. This issue is discussed in section 2(c) of the main response.

Q5 Do you agree that the OFT should take account of deterrence when considering whether to apply its 'de minimis' discretion? If so, how?

Yes. I agree that the OFT should adopt a case-by-case approach to assessing whether a transaction has an anti-competitive rationale (and should not apply a "standard deterrence multiplier").

Q6 Is it reasonable for the OFT, in considering whether to apply a 'deterrence multiplier', to have regard to the economic rationale behind a merger?

Yes.

Q7 The OFT stated in its previous guidance that it might consider use of the exception less appropriate where a reference would have important precedent value, for example,

because the case raises novel issues, so that an in-depth CC inquiry would provide guidance for the industry concerned. Do you consider this caveat should be retained?

Yes. Other parts of the draft Guidance contemplate that a case might be referred because of its implications for other cases, even though the first case, taken in isolation, might otherwise have been cleared applying the *de minimis* exception (see in particular paragraph 2.51). It is difficult to envisage a case in which "precedent value" would justify a reference, but it is not always easy to predict what cases will emerge in the future and the statement in the previous guidance leaves open the possibility of making a reference in such a situation.

Q8 Do you agree with the OFT's stated intention to use 'de minimis' to reduce, where possible, the costs of a phase one investigation?

Yes.

Q9 Are there any other mechanisms, other than those listed, by which the OFT should use the 'de minimis' discretion to reduce the burden of merger control?

None that I can think of.

Q10 Are there any concerns about parties being willing to waive their procedural right to an issues letter and issues meeting if the OFT would, in any event, apply the de minimis exception?

No. Issues letters are prepared for the benefit of the notifying party as part of their rights of defence, and they should be entitled to waive that right.

Q11 Is the right level of detail given in relation to how the OFT exercises its 'de minimis' discretion? If more detail is required, in what areas should this be?

See the response to Question 4 above.

<u>Questions about arrangements insufficiently far advanced/ insufficiently likely to proceed</u>

Q12 Do you believe there are any types of situation in which the OFT has not historically employed this exception but where it should do so going forward?

It would be useful to address in the draft Guidance the issue that arises when one party, A, announces a possible offer for B, and other parties C, D and E respond by expressing interest in acquiring B. There are clearly benefits in all four possible offers for B being considered together, in terms of efficiency and avoiding the risk of inconsistency. At the same time, if any of C, D and E is unlikely to make a formal offer for B and wishes to participate as a main party in the merger proceedings for ulterior purposes (for example to complicate matters for A and/or to exercise greater influence over the development of the case law than it could as a third party), it seems to me that that party should not be included in the review (whether because there is not a merger "in contemplation" or the merger is "not sufficiently likely to proceed"). In assessing this issue, the OFT would in practice presumably be limited to asking questions of the parties, scrutinising their public announcements and reviewing their internal documents, to the extent that they are not privileged.

<u>Questions about customer benefits</u>

Q13 Is the OFT applying the correct evidential standard in relation to customer benefits?

Yes.

Q14 Do you agree with the OFT's explanation of the relationship between efficiencies that prevent a substantial lessening of competition from occurring and relevant customer benefits that outweigh an identified substantial lessening of competition?

Yes.

Q15 Is it right to consider evidence on customer benefits on a sliding scale?

Yes.

Q16 Why have parties been unable to substantiate a customer benefits exception at phase one under the Act to date?

The right case has not yet arisen. Certainly, the decision in *Global Radio / GCap Media* leaves plenty of scope for parties to benefit from the customer benefits exception in an appropriate case, and therefore encourages notifying parties to argue customer benefits points.

It would be helpful to make clear in the draft Guidance that the customer benefits exception could be used in the case of a near-failing firm, where the merger avoids a complicated and messy transfer by customers to a new supplier (cf. the European Commission's decision in *News Corp / Telepiù*[13]). This involves customer benefits in terms of lower prices (because the customers avoid the costs of a service interruption and arranging a new provider) and/or higher quality (because of service continuity).

<u>Questions about undertakings in lieu</u>

Q17 In what circumstances, if any, should the OFT be willing to accept a mitigatory remedy given that there remains the possibility of a reference to the CC?

None other than those specified in the draft Guidance in paragraph 5.16.

Q18 Should the OFT be concerned about a risk of over-enforcement in terms of accepting undertakings in lieu (potentially requiring significant divestments), particularly given the level of the reference test?

No. The notifying party is best placed to decide whether the benefits in terms of avoiding a reference outweigh the costs in terms of possible over-remedying, and there is no reason for the OFT to interfere in that assessment.

Q19 Should the OFT be prepared to allow parties to abandon/totally unwind a transaction through undertakings in lieu?

Yes. There is no benefit in forcing a purchaser on a completed transaction to go through the Competition Commission process if it has determined that the transaction needs to be unwound.

---

[13] Case COMP/M.2876, para. 211: "the risk of Stream exiting the market, if it were to materialise, would be a factor to take into account when assessing the present merger. The Commission further considers that an authorisation of the merger subject to appropriate conditions will be more beneficial to consumers than a disruption caused by a potential closure of Stream."

Q20 Do you agree that proportionality of the divestment in the context of the wider transaction is irrelevant at OFT stage?

Yes. It is for the party providing the undertakings to make a commercial judgement about how far they are willing to go.

Q21 Do you agree that the OFT does not have the power to accept undertakings in lieu from a purchaser of divestment assets?

Yes.[14]

Q22 In what circumstances, if any, should the OFT seek informal ongoing behavioural commitments from a purchaser of divestment assets or a divestment business?

The OFT should not seek or accept such ongoing behavioural "commitments" because there is no mechanism for enforcing such commitments and it is bad practice to place weight on a "commitment" that ultimately cannot be enforced. (See also the discussion of footnote 74 of the draft Guidance in paragraph 3.3 of the main response.)

Q23 Do you agree that the OFT's use of the upfront buyer mechanism provides a proportionate means of addressing divestment risk? Are there any risks around this mechanism that might be addressed?

See section 2(d) of the main response.

[14] Obviously if, notwithstanding paragraph 5.34 of the draft Guidance, the OFT had jurisdiction to review the sale of the divestment assets and found that the test for a reference was met, then it would have power to accept undertakings in lieu from the purchaser of the divestment assets.