



## MERGERS – EXCEPTIONS TO THE DUTY TO REFER AND UNDERTAKINGS IN LIEU

### RESPONSE TO THE OFT'S CONSULTATION

#### 1. INTRODUCTION

- 1.1 Ashurst LLP welcomes the opportunity to respond to the Office of Fair Trading's ("**OFT**") consultation paper on *Mergers – Exceptions to the Duty to Refer and Undertakings in Lieu* ("**the Consultation Document**"). This type of guidance plays an important role in helping to make the merger control process transparent and fair for its users by ensuring that the approach taken by the OFT is predictable and known.
- 1.2 As legal advisers, we frequently represent clients before the OFT in merger control cases and our comments are made from that perspective. This response is made on our own behalf, in light of our general experience of the issues raised in the consultation paper, and is not made on behalf of any particular clients.
- 1.3 In order to avoid repetition, we have responded to the questions as they are grouped together in Annex A of the consultation paper, rather than providing an individual response to each question.

#### 2. QUESTIONS ABOUT MARKETS OF INSUFFICIENT IMPORTANCE ('DE MINIMIS')

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

### **Introduction**

- 2.1 We agree that the concept of "importance sufficient to warrant reference" should not simply be regarded as a question of market value. We also agree with the use of a wider frame of reference to assess this issue.

### **Market size**

- 2.2 We consider that the proposed threshold of £10 million is appropriate although some flexibility should be applied in borderline cases. We also welcome the OFT's clarification that only markets where the OFT concludes that there is a realistic prospect of a substantial lessening of competition ("**SLC**") are to be included for the purposes of the £10 million threshold.<sup>1</sup> We note that the Consultation Document states that market size may "*exceptionally* [emphasis added] *be adjusted for the purposes of the 'de minimis' exception where it is clear that the size of any consumer detriment will be experienced by only a subset of the overall market*".<sup>2</sup> In our view, it should not only be in 'exceptional' cases that the market size should be adjusted in such a way: in essence, in such circumstances, the SLC which the OFT has identified does not extend to all products/services or customers in the relevant market and it seems appropriate to adjust for this as a matter of general approach so that the consumer harm which the OFT is weighing against the cost of a reference is delineated as accurately as possible.
- 2.3 We consider that the OFT's statement that it would expect the de minimis exception generally to apply where the size of the affected market is below £3 million is helpful. However, in the interests of transparency, it would be helpful to see how this £3 million figure was arrived at.

### **The role of deterrence in the de minimis assessment**

- 2.4 Whilst deterrence is a relevant factor for the OFT to consider, we believe that the OFT should be cautious in seeking to apply the policy too broadly, particularly given the voluntary nature of notifications under the UK merger control regime. Deterrence in the merger control context is largely concerned with the issue that potentially problematic mergers may go undetected by the OFT due to the voluntary nature of the UK regime. Our experience is that it is rare for parties who are aware that their transaction may well raise competition issues to choose a "below the radar" strategy of not notifying the OFT. Thus, the number of mergers that the OFT may be concerned about deterring is in our view small and likely to be increasingly so in light of the OFT's appointment of a dedicated Mergers Intelligence Officer and the ability of customers, suppliers and competitors to complain.

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<sup>1</sup> Paragraph 2.30, first bullet point.

<sup>2</sup> Ibid, sixth bullet point.

- 2.5 De minimis, however, is a specific exception to the duty to refer in relation to small mergers where the consumer harm is considered to be outweighed by the costs of reference. We would therefore question the extent to which deterrence has a material role to play in making de minimis decisions. Indeed, we would query whether potential de minimis cases where a reference is made (partly on the basis of deterrence) do indeed have a wider deterrence effect. In that regard, we note that the Deloitte Report<sup>3</sup> to which the Consultation Document refers (at paragraphs 2.43 to 2.45) considered the deterrent effect of the OFT's merger control work as a whole and did not consider the effect that taking account of deterrence in de minimis decisions might have. In fact, that Report does not discuss de minimis at all.
- 2.6 Moreover, as that Report pointed out, "*The precedential impact of OFT or CC decisions was generally said to be in the sector concerned rather than being felt across the economy.*"<sup>4</sup> This accords with our experience that parties contemplating a merger in any given sector will have strong regard to OFT and CC decisional practice in that sector (as well as the authorities' published guidance and relevant case law) when considering how their merger is likely to be reviewed, but decisional practice in other sectors is generally only of marginal relevance as regards substantive assessment. In our view, this further reduces the relevance of deterrence in de minimis assessments and we believe that it is preferable for de minimis cases to be considered on their own merits using the analytical framework and weighing up all the other factors that are properly described in the Consultation Document. There should be no presumption that a wave of similar mergers as described in paragraph 2.51 of the Consultation Document would occur, unless the OFT has identified sufficiently compelling evidence of such an outcome.

#### ***Interaction between de minimis and potential undertakings in lieu***

- 2.7 As the OFT rightly states in the Consultation document,<sup>5</sup> the Enterprise Act 2002 ("**the Act**") is clear on the sequence of questions that the OFT must ask itself when considering exceptions to the duty to refer and the issue of undertakings in lieu ("**UIILs**"): thus, the OFT must consider whether any exception to the duty to refer is engaged separately and prior to considering whether to accept any UIILs that have been offered.
- 2.8 We are concerned that by taking into account the availability of UIILs in determining whether the de minimis exception is engaged, the OFT is conflating two distinct legal steps in its assessment. This conflation has undesirable consequences which highlight why the Act keeps the issues of de minimis and UIILs quite separate. First, the OFT's approach encourages parties to a transaction to attempt to "game the system" as, in cases where de minimis is in play, there is an incentive for the parties to argue that no realistic UIILs are available with the objective of securing an unconditional de minimis clearance. Secondly, irrespective of what the parties might argue, the OFT's approach suggests that "binary" cases where the only "remedy" is prohibition, have a greater chance of benefiting from de minimis than cases where there is a clear – usually structural – remedy available: a point which the OFT implicitly acknowledges in paragraph 2.26 of the Consultation Document. We do not see an obvious rationale for this outcome and, given that in a large number of cases where an SLC may arise, clear-cut UIILs are available "in principle", the availability of de minimis would seem to be materially limited, not least because the divestment may render the transaction commercially unviable.
- 2.9 A final point we would note is that, if the OFT does conclude that the availability of UIILs in principle are relevant to de minimis assessment, the interests of fairness and transparency dictate that the OFT should be full transparent with the parties as to its

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<sup>3</sup> **The deterrent effect of competition enforcement by the OFT: a report prepared for the OFT by Deloitte**, OFT962, November 2007.

<sup>4</sup> Ibid at paragraph 4.45.

<sup>5</sup> Paragraphs 2.19 to 2.20.

thinking regarding the availability of UILs. In this regard, we note that paragraph 8.8 of the current *Mergers: Jurisdictional and Procedural Guidance* does indicate that OFT case teams will be transparent with the parties in respect of their thinking on UILs and we would welcome further clarification on this, specifically within the de minimis context.

***Mergers involving small and medium sized businesses***

- 2.10 We note that the Consultation Document does not discuss the relevance of the de minimis exception to mergers involving small and medium sized enterprises. In our experience, such businesses find references to the Competition Commission disproportionately onerous. Their small scale means that the additional legal costs and management time required to deal with the reference process cannot easily be absorbed (and indeed often exceed the expected return on investment in the target) and will be materially disruptive to the management of the business. As a result, the likelihood of a merger involving small and medium sized enterprises being abandoned if a reference is made is significant. The consequences of abandonment may be particularly acute. For instance, in a narrowly defined local market, there may be only one realistic purchaser for a business and such a transaction may result in very high market shares. However, the purpose of the transaction may be to allow the owners of the target to realise their investment (for example, in order to retire), and a business sale may be the only way to do so. We would encourage the OFT to take such issues as to the costs and effect of a reference for small and medium sized businesses into account in its evaluation.

***Other comments***

- 2.11 We would welcome further amplification and clarification of some other points. First, at paragraph 2.39 of the Consultation Document, the OFT states that particular weight will be placed on the magnitude of competition lost by the merger where a substantial proportion of the likely detriment is suffered by 'vulnerable' consumers. Explanation as to how the OFT would identify such consumers would be welcome.
- 2.12 Second, in respect of the issue of whether to send an inquiry letter in respect of a non-notified merger, the OFT states that it will not do so where it is "very confident" that the affected markets are of insufficient importance to justify a reference "regardless" of the magnitude, likelihood or duration of SLC,<sup>6</sup> we would welcome further discussion of the type of scenario and evidence that might lead the OFT to reach such a conclusion.

**3. QUESTIONS ABOUT ARRANGEMENTS INSUFFICIENTLY FAR  
ADVANCED/INSUFFICIENTLY LIKELY TO SUCCEED**

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?
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- 3.1 Our only comment on this section is in relation to paragraph 3.4 where the OFT states that it will take a view soon after notification "as to whether a full competition analysis was not required because of the early stage of proceedings". Whilst we understand the OFT's sentiment, in our view the scheme of section 33 of the Act is such that the discretion not to refer on the ground that the arrangements are not sufficiently advanced can only come into play once the OFT has decided that the duty to refer is in fact engaged. Clearly, the OFT can only decide if the duty to refer is engaged after it has carried out a sufficiently detailed competition analysis.

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<sup>6</sup> Paragraph 2.58.

#### 4. **QUESTIONS ABOUT CUSTOMER BENEFITS**

Q13	Is the OFT applying the correct evidential standard in relation to customer benefits?
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?
Q15	Is it right to consider evidence on customer benefits on a sliding scale?
Q16	Why have parties been unable to substantiate a customer benefits exception at phase one under the Act to date?

- 4.1 We broadly agree with the approach that the OFT is proposing and, in relation to customer benefits, see little departure in the consultation document from the OFT's original *Mergers: Substantive Assessment Guidance*. As the OFT notes at footnote 46 to paragraph 4.8, it has not, to date, exercised its discretion under the Act not to refer a merger on the basis that the customer benefits exception was made out. Given this lack of decisional precedent, it would be helpful for the OFT to explain in more detail its illustrations of potential customer benefits set out in paragraphs 4.13 to 4.16.

#### 5. **QUESTIONS ABOUT UNDERTAKINGS IN LIEU OF REFERENCE TO THE CC**

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?
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?
Q19	Should the OFT be prepared to allow parties to abandon/totally unwind a transaction through undertakings in lieu?
Q20	Do you agree that proportionality of the divestment in the context of the wider transaction is irrelevant at OFT stage?
Q21	Do you agree that the OFT does not have the power to accept undertakings in lieu from a purchaser of divestment assets?
Q22	In what circumstances, if any, should the OFT seek informal ongoing behavioural commitments from a purchaser of divestment assets or a divestment business?
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?

#### ***Proportionality***

- 5.1 We note the comment at paragraph 5.20 of the Consultation Document that, where it is presented with a range of UILs which are all sufficient to deal with its concerns in a clear-

cut matter, the OFT will accept the least intrusive or most proportionate remedy. This is clearly a sensible and proper approach. However, what is less clear is the OFT's approach where it is presented with a single remedy which deals with SLC that had been found in a clear-cut fashion but, in the OFT's view, goes beyond what is strictly required to deal with the SLC e.g. an offer is made to divest businesses A and B where the OFT's conclusion is that only the divestment of business A was required. In our view, such a remedy should be accepted by the OFT and the fact that the parties have offered more than may have been required is an outcome they are prepared to accept (or, indeed, the scope of the offer may be quite deliberate by the parties for perfectly legitimate commercial reasons not related to the SLC issue, for example, to provide a more attractive commercial package for potential purchasers and thereby achieve a higher sale price). It may be that this is the OFT's position (as set out in paragraph 5.23 of the Consultation Document) but, if it is, we would suggest that this be clarified.

- 5.2 In the same vein, we do think that parties should be permitted to offer to unwind a transaction as a UIL, although we think such cases are likely to be extremely rare.

***Use of an upfront buyer***

- 5.3 Paragraph 5.40 of the Consultation Document seems to imply that the use of the upfront buyer mechanism will be the OFT's default position when divestment UILs are being considered. If this is so, we think this should be absolutely explicit and should be accompanied by a more detailed discussion of when the upfront buyer mechanism will and will not be applied.

**ASHURST LLP**

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