

MERGERS – EXCEPTIONS TO THE DUTY TO REFER & UNDERTAKINGS IN LIEU

CBI response to OFT's consultation – 15 January 2010

GENERAL

The CBI strongly supports clearer guidance from the OFT on its *de minimis* practice to enable small mergers to take place without the need for a costly review.

As mergers are a normal and essential activity in the economy we are concerned by references in many parts of the document that deterrence is an important factor in the OFT's merger policy. Since the vast majority of mergers are benign, we believe this fact should be recognised in the document and a much more positive approach indicated.

We suggest the essential role of the OFT under the Enterprise Act is to assess the proposed merger on its own merits and its consistent practice over time will allow companies to carry out a self-assessment under the voluntary notification regime. Its practice can be reviewed over time to judge its effect on deterring anti-competitive mergers but in our view, deterrence should not be a relevant factor in its approach to reviewing mergers.

How useful this document will be in practice will be judged by how clear and firm is the guidance. Reviewing the document there are a number of important caveats which create considerable uncertainty. If the guidance could be strengthened we believe it would be a more useful reference.

Taking account of the questions posed in the document we are responding below with some specific comments which reflect a business view.



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SPECIFIC COMMENTS

Cost/benefit analysis – Section 2.

We strongly support the OFT's use of a cost/benefit analysis. We fully endorse the statements, in paragraphs 2.1 and 2.5, that the exception should avoid references being made where the costs involved would be disproportionate to the size of the market concerned.

For a company considering the likelihood of an OFT review, the costs of legal advice, with input from economists, can easily be £100,000. The costs of a CC review can exceed £1m. To these costs the internal costs of the OFT and the CC have to be added.

These are known quantifiable costs whereas, on the other side of the equation, the estimate of possible consumer harm should the merger proceed, must be speculative. There are so many variables, from the likely growth in the economy to possible new entrants from outside the UK, that any estimates over even the short-term must be subject to large variances.

We agree with the OFT that in exercising its discretion not to refer a merger it should take a proportionate approach. In fact we would suggest this is a duty under the Hampton principles. The question is what should be taken into account in applying this approach.

In contrast to the OFT, we believe it is legitimate to take into account a reasonable estimate of the costs that would be incurred by the parties if a reference was made. To disregard these costs adds considerably to the regulatory burden faced by the parties and has a disincentive effect on mergers. As indicated above, these are real quantifiable costs that would be incurred by the parties.

There is a reference, in paragraph 2.7, to the merger control system, as with other competition policy tools, being based on a consumer welfare standard. But the other competition policy tools addressing abuses of a dominant position or cartels are fundamentally different as they are designed to protect the consumer interest against unlawful conduct.

Mergers are in an entirely different category and are one of the essential tools for achieving business growth. The common rationale for them is to increase efficiencies and economies of scale. This in turn leads to higher economic growth and an increase in consumer welfare. Accordingly, they should generally be viewed in a positive light and as important contributors to consumer welfare

Taking this approach, we believe it is both logical and proportionate to include business costs incurred in a CC reference. The parties will have already incurred considerable costs in self-assessment and in a review by the OFT. It would seem unreasonable not to take account of the parties' further costs on a CC reference. These are incurred in respect of a proposed activity which, on the most common view, contributes to consumer welfare.

Size of affected market(s) below £3m. – Section 2.14

It is helpful to set out a figure of £3m. where the OFT would expect the *de minimis* exception generally to apply. While we appreciate that the OFT cannot create a “safe harbour” under the present legislation, we would urge the OFT to expand this section with fuller explanations of the basis for this. While not a safe harbour, it would be of considerable benefit to business and legal advisers.

This welcome statement is unfortunately followed in Section 2.15 by a substantial caveat that it does not follow that where the aggregate size of the market(s) is below £10m. the exception will generally be applied *or is even likely to be applied*. (emphasis added)

What would be very helpful to business is a clear indication by the OFT of the level of market size below which the OFT will not generally need to consider in detail issues such as consumer harm and availability of undertakings in lieu. In this case, the market size alone would be sufficiently small that even undertaking the analysis otherwise required by the OFT’s *de minimis* policy would be disproportionate. We would welcome a clearer indication from the OFT that such a market size is £3m.

We believe business would also appreciate the OFT providing informal guidance on the relevance of this market size in a particular case.

Deterrence as an indirect benefit – Section 2.

We support the statement in Section 2.49 that transactions that are essentially benign or pro-competitive should not be deterred by merger control. We believe statistics show that over 90% of mergers fall into this category.

We are very concerned though by other statements such as the application of *de minimis* should not undermine the deterrent effect of the merger control regime (Section 2.47).

We have expressed concern about whether the OFT should have deterrence included as a policy objective. Merger review is a regulatory activity for which parties have to pay a substantial fee and in a quite different category to pursuing cartels or abuses of market power. The review by the OFT is in principle being paid for by the parties and in analysing a specific merger we do not believe that deterrence is a relevant factor.

When the OFT’s role is analysed in this way, we believe it would be incorrect to draw a conclusion from the Deloitte Deterrent Effect Report that there is a deterrent effect in mergers that can be equated to the deterrent effect in cartel or abuse cases.

Accordingly we disagree with statements in Sections 2.10 and 2.16 that there are indirect deterrent effects that may be taken into account when considering the cost/benefit analysis. We question the legitimacy of this approach and suggest the OFT seriously reconsiders this point.

Vulnerable consumers – Section 2.39

In terms of its statutory remit, we believe it is questionable whether the OFT is correct in giving particular weight to the possible detriment that could be suffered by vulnerable consumers. The statement raises the question of whether consumer protection principles are outweighing a strict application of the SLC test.

As it stands, the statement is capable of wide interpretation and we believe clarification is needed.

Proportionality of undertakings in lieu – Section 5.18

We support the statement, in Section 5.19, that the scope of undertakings in lieu should not go beyond what is necessary to remedy identified competition concerns in any particular case.

However, this is countered to a large extent by the statement, in Section 5.21, that the OFT may require a greater set of remedies than might ultimately be needed if the merger were to receive a detailed, second-phase investigation by the CC. It is said, in the following Section 5.22, that the parties retain the choice to have their case examined in detail at the CC stage.

The OFT recognises that it is under a duty to act in a manner that is proportionate and we believe this is particularly crucial when agreeing undertakings in lieu. By this stage the parties will have invested a great deal in the planned merger, in legal and in internal costs. Merger plans typically have a life of about six months because of the significant integration costs that are required. If they cannot be completed in that time, the companies will generally consider other options.

The threat of a CC reference causes many mergers to be abandoned because of the substantial costs and delay involved. It therefore represents a very powerful incentive for the parties to agree to the terms proposed by the OFT and provides considerable leverage for the OFT in negotiating undertakings.

Because of this dynamic, we consider that the OFT has a particularly strong duty to act proportionately and we question whether it is correct for the OFT to require a greater set of remedies than might ultimately be imposed by the CC. The suggestion that there is an alternative available to the parties to have their case reviewed by the CC is we believe illusory, as this is open to few parties in practice.

CONCLUSION

We welcome the OFT's initiative in revising its guidance and acknowledge the steps taken to provide more help to business. We would be pleased to continue working with the OFT to further develop clearer rules for small mergers.