

**OFT CONSULTATION ON EXCEPTIONS TO THE DUTY TO REFER AND  
UNDERTAKINGS IN LIEU: RESPONSE OF CLIFFORD CHANCE LLP**

1. **INTRODUCTION**

1.1 Clifford Chance welcomes the opportunity to comment on the proposals of the Office of Fair Trading ("**OFT**") for revisions to its guidance (the "**Draft Guidance**") on exceptions to the duty to refer and undertakings in lieu under the Part 3 of the Enterprise Act 2003 (the "**Enterprise Act**").

1.2 As a preliminary and general comment, we applaud the recent efforts of the OFT and CC to produce a coordinated guidance paper on substantive assessment. As we commented in response to that paper, we would like to see that trend continued, avoiding the proliferation of guidance papers with overlapping content. The Draft Guidance currently under consultation appears to undermine this trend. In particular, much of the content of the Draft Guidance is already covered (albeit in less detail) in the OFT's Jurisdictional and Procedural Guidance, in the CC's Merger Remedies Guidelines or in the recent combined OFT/CC draft Substantive Assessment Guidance, and we consider that it would have been preferable to introduce the relevant guidance and clarification by way of an update of those documents, or consolidation of the respective OFT and CC documents.

2. **DE MINIMIS**

2.1 Subject to our remarks below, we consider the Draft Guidance to be a coherent summary of the OFT's approach to the application of the *de minimis* exception, which contains useful additional clarification of points that were not covered in the 2007 guidance

**The £10 million threshold**

2.2 We have three observations on the £10 million threshold referred to in the Draft Guidance.

2.3 First, paragraph 2.7 of the Draft Guidance states that the OFT "considers it appropriate only to take account of public costs, and not those costs that might be incurred by the parties in the event that the reference proceeds. This is because the merger control system is based, as with other competition policy tools, on a consumer welfare standard." We consider that taking account of the parties' costs, at least to some degree, would be consistent with the enhancement of consumer welfare. Money saved through the avoidance of a reference (legal fees, administrative costs, management time etc, which will usually be substantially more than the average £500,000 cost to the CC) may be put to use by an enterprise in any number of welfare enhancing ways, such as job creation, investment in R&D, payment of taxes, or payments of dividends to shareholders that are often pension funds. In short, enhancements of "total" welfare will often benefit consumers.

2.4 Second, footnote 5 of the Draft Guidance explains the OFT's reasoning behind the £10 million threshold. As currently worded, the "scenario" on which the threshold is

based appears to be purely arbitrary. This impression could be avoided by expressly linking the variables within the scenario to the enforcement practice of the OFT and the CC. In particular:

- (a) a likely or possible 5% price rise is generally the minimum increase that will trigger enforcement activity. Increases below 5% are generally considered insufficiently significant to merit enforcement action (partly due to excessive risk of Type II errors), and this is reflected in the lowest percentage price increase to which the SSNIP test is applied;<sup>1</sup> and
- (b) if a price increase is not expected to endure, because it is expected that such an increase would trigger new entry or expansion within two years, that will not typically result in enforcement action by the OFT or CC.<sup>2</sup>

In this way, the scenario (and, ultimately, the threshold on which it is based) would be defined by reference to the set of all cases in which the likely public costs of referring a case might outweigh its likely public benefit.

- 2.5 Third, the Draft Guidance also refers to a £3 million threshold (where the *de minimis* exception is "generally expected" to apply (paragraph 2.14), and a £6 million figure, where the exception is "unlikely" to be applied unless "other relevant factors strongly suggest" otherwise (footnote 6). While we agree that there is value in providing a figure below which the *de minimis* exception will usually apply, the £6 million figure seems to us unnecessary (given the detailed guidance provided in paragraphs 2.28 to 2.39 of the Draft Guidance) and likely to create uncertainty. Consequently, we suggest that the relevant text in footnote 6 is deleted.

#### **"In principle" assessment of whether UILs available**

- 2.6 We agree that it is important that the OFT carries out its "in principle" assessment of the availability of clear-cut undertakings in lieu ("UILs") prior to, and independently of, consideration of any offer of UILs by the parties. As examples of the potential consequences of this approach, the scenarios in paragraph 2.27 and footnote 12 are useful. However, we consider that it would be of greater interest if the OFT were to set out what it would do in the following scenario:
- (a) the OFT's "in principle" assessment concludes that clear cut UILs are available, and for that reason alone decides that the *de minimis* exception should not be applied; and
  - (b) the OFT then goes on to consider UILs offered by the parties and subsequently concludes that, in fact, clear cut UILs are not available. This might be, for

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<sup>1</sup> See paragraph 3.17 of the OFT's "Mergers: Substantive Assessment Guidance" (OFT516), paragraphs 2.7 and 2.8 of the CC's Merger Reference Guidelines and paragraph 4.55 of the Draft joint OFT/CC "Merger Assessment Guidelines" (currently under consultation).

<sup>2</sup> See paragraph 4.23 of the OFT's "Mergers: Substantive Assessment Guidance" (OFT516) and paragraph 4.189 of the Draft joint OFT/CC "Merger Assessment Guidelines" (currently under consultation).

example, due to factors of which the OFT only became aware as a result of its consideration of a detailed set of actual UILs.

- 2.7 We suggest that the Draft Guidance makes it clear that in the above scenario the OFT will make an exception to the rule that actual, offered UILs have no bearing on the "in principle" assessment and will (if all the other factors are present) apply the *de minimis* exception.

**Deterrent benefit of merger control decisions**

- 2.8 We consider that focusing on the "deterrent" effects of merger control decisions is unhelpful. While adverse OFT decisions may deter future anticompetitive mergers (but see our comments below regarding the statistics presented in the Draft Guidance), they may also facilitate beneficial mergers that would otherwise have been considered too risky. Consequently, we submit that the Draft Guidance ought to revert to focusing on the "precedent value" of merger decisions.
- 2.9 In addition, we have reservations regarding the interpretation of Deloitte's 2007 Deterrent Effect report. Footnote 28 and paragraph 2.46 of the Draft Guidance appear to assert that there is a numerical causal link between OFT enforcement action in a particular case and subsequent anticompetitive mergers that do not proceed, i.e. that if the OFT does not take enforcement action against a potentially anticompetitive merger then two or three anticompetitive mergers will proceed that would otherwise have been deterred. We see nothing in the Deloitte report that supports such an assertion. In particular, that report merely sets out a ratio between cases pursued by the OFT and mergers that had been abandoned or modified on competition grounds, following external legal advice. While that may be an indication of the deterrent effect of the UK merger control regime as a whole, it offers no useful information on the "marginal" deterrent effect of individual cases, or particular categories of cases (such as *de minimis* cases). Given the presence of a large body of previous decisions and extensive published guidance, the deterrent effect of individual cases may in fact be negligible. Moreover, paragraphs 2.43 to 2.46 do not appear to be essential to understanding the OFT's approach to considering the deterrent effect (or precedent value) in individual cases, which is described in subsequent paragraphs. Consequently, we suggest that paragraphs 2.43 to 2.46 are deleted.
- 2.10 As regards the concern that "failure to discourage obviously harmful mergers via the 'de minimis' exception (even in a small market) would be perverse", it seems to us that the *de minimis* exception will be rendered ineffective if the Draft Guidance goes too far in attempting to deter anticompetitive mergers in very small markets. It is within the very nature of a *de minimis* exception that some SLC mergers in small markets will proceed, where they would not have done in the absence of the exception. The aim of deterring such mergers cannot be completely reconciled with a *de minimis* policy and must therefore be very carefully and precisely circumscribed. The Draft Guidance does not do that. In particular, in the absence of "smoking gun" documents, the assessment of whether the primary economic rationale for the transaction is anticompetitive<sup>3</sup> (as opposed to, say, the creation of efficiencies) will be highly

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<sup>3</sup> Paragraph 2.50 of the Draft Guidance.

subjective and create significant legal uncertainty. In our view, it would be preferable to limit the *de minimis* exception in two clearly defined ways:

- (a) First, where the merger is one of a potentially large number of similar mergers involving the same product market but different, local geographic markets (the similar reference in paragraph 2.51 to "similar mergers that could be replicated across the sector in question" is far too vague in our view);
- (b) Second, we suggest that the Draft Guidance restores the caveat contained in previous guidance for mergers giving rise to novel substantive issues that have considerable precedent value, because they have not been fully considered or resolved before. We consider that such cases would be very rare. They might, for example, involve cases where coordinated effects form the only credible theory of harm, or a "diagonal" merger of the type described in the draft joint OFT/CC Substantive Assessment guidance. In contrast, a merger should not be excluded from application of the *de minimis* exception purely because the definition of the product market in question has not been considered before.

### **Other points**

2.11 Other minor observations are as follows:

- (a) We agree with the OFT's suggested policy of using the *de minimis* exception to reduce the costs of a phase I investigation. However, it is important that in any case where the parties' rights to a full investigation have been waived, the OFT makes no finding in its decision as to whether its duty to refer is met. Paragraph 2.68 implies that it might make such a finding where the duty to refer is clearly met, which would cause considerable problems (and potentially a great deal of unfairness) in the event of a successful third party appeal of the OFT's decision to apply the *de minimis* exception.
- (b) It would be helpful if there were some explanation of which consumers would be viewed by the OFT as "vulnerable" for the purposes of paragraph 2.39.
- (c) Paragraph 2.33 might also add that in-depth scrutiny of benign mergers is also a waste of resources contributed by taxpayers.

## **3. CUSTOMER BENEFITS**

3.1 As regards the distinction set out in the Draft Guidance (at paragraph 4.4) between efficiencies that prevent an SLC from arising, and relevant customer benefits ("RCBs") that might outweigh an SLC, we agree that a valid and useful distinction can be made between the two concepts on the basis of the markets in which they arise (such that RCBs in one market may outweigh an SLC in another). However, we consider that the suggested distinction on the basis of individual "aspects" of competition is conceptually difficult and reliant on potentially artificial distinctions between aspects of the product or service offering in question. For example, the Draft Guidance states that "an increase in price might be outweighed by an increase in quality", but that could be expressed instead simply as improved value for money. In

addition, it is not consistent with the example given in paragraph 4.13 (first bullet), in which there appears to be no worsening of any individual "aspect of competition". In our view, a more pertinent distinction would be between those efficiencies that may be expected to spur (or, at least, not to worsen) the process of rivalry in the market in question, and those that may not (such as in the case of a merger to monopoly).

- 3.2 In addition, we do not understand why, in paragraph 4.15, the Draft Guidance states that the OFT's "normal expectation" is that customer benefits will arise in the market where competition concerns arise and that "clear and compelling evidence" is required to show that RCBs in one market outweigh an SLC in another. As noted in paragraph 4.12, evidence on RCBs in *any* market must be compelling in order to be taken into account, and we do not consider there to be any justification for applying a stronger presumption against RCBs that do not arise in the same market as an SLC.
- 3.3 In our view, it would be more useful if the Draft Guidance were to provide examples of circumstances in which RCBs in one market might outweigh an SLC in another. For example if a merger involving product markets A, B and C (of equal value) might be expected to result in prices 10% lower in markets A and B, but would give rise to an SLC and a 10% price rise in market C, then the "net benefit" of the merger for consumers is positive. The question therefore becomes whether the benefits in markets A and B can be achieved independently of the SLC in market C (such that they would not be affected by a remedy to address that SLC and therefore would not amount to RCBs by operation of Section 30(2)(b) of the Enterprise Act). That might not be the case where, for example, common infrastructure or equipment is used for the production of products in all three markets.

#### 4. **UNDERTAKINGS IN LIEU**

##### **Relevant customer benefits**

- 4.1 Paragraph 5.17 of the Draft Guidance states that "the OFT will not accept undertakings in lieu of reference that do not address the identified competition effects but which are designed instead to 'lock in' sufficient customer benefits to outweigh the risks of a substantial lessening of competition arising". In our view, this policy decision risks deterring mergers that have net benefits for customers and consumers. We submit that the OFT should retain its discretion not to refer in cases where it is impossible to frame a remedy that completely eliminates an SLC, but it is possible to offer a clear-cut remedy that mitigates the SLC and at the same time locks in RCBs (for which there is clear and compelling evidence) that outweigh the remainder of the SLC. Such an approach would be consistent with the wording of Section 73(2) of the Enterprise Act - which allows UILs that mitigate (but do not prevent or remedy) an SLC - and with Section 73(4) of the Enterprise Act.

##### **Acceptance of UILs from third parties**

- 4.2 In response to the question posed by the OFT regarding whether it has the power to accept UILs from parties who are not a party to the transaction under consideration, we consider that there is no overriding reason relating to policy or statutory interpretation for excluding this possibility. In particular, the Enterprise Act does not

define "party concerned" for the purpose of Section 73 and in our view a plain meaning interpretation would allow a prospective purchaser under a UIL to be considered to be "concerned" for these purposes (in the same way as, for example, the OFT has treated the vendor in the main transaction as being sufficiently "concerned").<sup>4</sup> Allowing UILs from prospective purchasers in certain limited and exceptional circumstances would have clear benefits. For example:

- (a) it would enable a prospective buyer with an overlapping business to purchase a divestment asset, on condition that the buyer undertook to sell its pre-existing overlapping business. This would be particularly useful where, for example, a purchaser wants to buy a package of numerous divestment stores, only one of which overlaps with a store of that purchaser. In those circumstances, accepting a UIL from the purchaser to divest its overlapping store within a reasonable time would be a substantially more proportionate approach than refusing to approve the purchaser; or
- (b) such UILs could be used to address a concern on the part of the OFT regarding economic links between one of the parties to the transaction and the prospective purchaser, in circumstances where only the purchaser has the power to sever those links (e.g. if the purchaser has a shareholding in one of the parties).

4.3 However, in our view the OFT should limit the use of such "third party" UILs to structural undertakings. In particular, we consider that the OFT should not accept undertakings that combine divestment undertakings with behavioural undertakings on the part of the prospective purchaser (such as an undertaking to operate the divestment business as a viable competitor) unless there are truly exceptional circumstances, and the relevant conduct amounts to a limited number of discreet and easily verifiable actions.

#### **Undertakings to unwind a transaction**

4.4 We strongly support the proposal that the OFT accepts UILs to unwind a transaction in its entirety. We consider that the OFT's current approach penalises unfairly companies that have completed their transaction (often having had little choice except to complete, for example in the context of an auction process). Forcing such parties to go through the onerous and expensive process of a CC inquiry is disproportionate and unreasonable if there is on offer a clear cut remedy that will restore competition to pre-merger levels (which will inevitably be the case if initial undertakings or orders have been put in place to prevent integration of the enterprises in question). A policy of accepting undertakings to unwind a transaction would also give the merging parties greater incentives to offer and to comply with interim undertakings.

4.5 There have been a number of cases involving the referral of a completed deal in what appear to be relatively low value transactions. The cost of going through a reference may be significant and represent a disproportionate amount of the overall transaction

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<sup>4</sup> As per footnote 51 of the Draft Guidance.

cost. If the *de minimis* exception is a mechanism designed to reduce the impact of a reference on the public purse, the ability of merging parties to abandon completed deals at Phase I should be allowed as an equivalent mechanism to reduce the impact on the parties' purse.

#### **Choice of divestment asset**

- 4.6 We support the OFT's position that in appropriate cases it will give parties the choice of whether to sell an asset of the target or of the buyer. Having such a choice increases the chance of a successful divestment, as there may be more prospective buyers for one asset than the other, and the better asset may well belong to the purchaser. Moreover, if the merging parties fail to sell the divestment asset, that choice will be for the benefit of a trustee. In some circumstances, affording the parties this option may mitigate the need for an upfront buyer.
- 4.7 We suggest that paragraph 5.26 makes it clear that the "appropriate cases" referred to in the third sentence of that paragraph are those in which the "buyer's existing business is a suitable remedy in terms of its saleability", as set out in the preceding sentence.

#### **Upfront buyers**

- 4.8 Upfront buyer ("**UFB**") undertakings delay completion of a transaction by a considerable amount of time and therefore greatly increase the likelihood that an anticipated transaction will be abandoned or will not even be considered. In particular:
- (a) the 40 working day timetable is already unusually long by EU standards and the addition of a further 3-4 months of UFB time amounts to a very large time lag between signing and completion; and
  - (b) from the buyer's perspective, the prospect of arranging the sale of assets becomes even more daunting if it must be carried out before it the buyer has even acquired ownership of the assets in question (unless the seller is prepared to be bound by the UIL).
- 4.9 In order to avoid the unintended consequence of deterring anticipated deals, UFB mechanisms should be used only where strictly necessary. We agree that, if there is a divestment risk, the OFT's use of the ("**UFB**") mechanism is a proportionate means of addressing it. However, the OFT should not be too quick to identify divestment risk (and in particular should not perceive exaggerated risks in light of the current economic climate). In our experience, such risks arise very rarely, and consequently it should continue to be the case that UFB remedies are used only in exceptional cases. We note that in certain retail markets, the OFT has sought UFB undertakings notwithstanding that it had previously experienced no particular difficulty in having a divestment remedy implemented.
- 4.10 It seems to us (both from paragraph 5.39 and from our own experience) that one of the OFT's reasons for favouring UFBs is that it does not consider its powers under section 75 of the Enterprise Act to be sufficient to deter breaches of UILs, particularly

breaches of deadlines contained in UILs. If that is the case, we consider it preferable that, instead of requiring UFBs in too broad a range of cases, the OFT explores other ways to increase parties incentives to comply with UILs. It might, for example, seek to bolster its section 75 powers (e.g. to allow it to impose fines for breaches of UILs) or set out a stricter policy for the use and enforcement of its existing section 75 powers .

- 4.11 As regards partial UFB mechanisms, paragraph 5.41 indicates only that the OFT may consider the use of such a mechanism appropriate in "some" cases. We suggest that the guidance explains that for multiple-asset divestment packages, the OFT will assess the necessity of a UFB separately for each discrete divestment asset and that, as a result, a total (as opposed to partial) UFB will only be considered appropriate if a UFB is considered necessary for every divestment asset in the package.

**The need for a sunset clause**

- 4.12 Finally, while the Draft Guidance does not address this point, the OFT's standard practice is for UILs to contain a perpetual prohibition on reacquisition of the divestment assets. We consider this to be disproportionate. In particular, it is unreasonable to assume that any identified competition issues will continue to exist forever, such that the parties need to apply to the OFT for a variation or cancellation of the undertaking no matter how much time has passed since it was imposed.
- 4.13 Accordingly, we consider that some form of sunset clause should be included in the OFT's standard form, so that the prohibition on directly or indirectly holding, acquiring, reacquiring or using the divestment asset falls away after an appropriate amount of time. We suggest that the appropriate period will generally be between five and ten years, depending on the market.

**Clifford Chance LLP**  
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