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By email and post

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Dear Nicholas

Exceptions to Duty to Refer and Undertakings in Lieu - Consultation Document

We welcome the decision by the Office of Fair Trading ('OFT') to provide further guidance on the operation of the exceptions to its duty to refer their interaction with undertakings in lieu, on the basis that such guidance provides a helpful insight into the OFT's current practice in this area. We are grateful for the opportunity to provide comments, which are offered in the interests of future policy formulation. They should not be taken to represent or reflect the views of any present or future client of the firm.

Given the OFT's request for respondents to address the questions raised in its consultation document, we have focused on these in this letter. Before turning to the questions, however, we would like to make some general comments. It seems to us to be a reasonable assumption that the potentially very high costs of a merger control review in the UK, combined with uncertainty over the occurrence and extent of any such review, could deter potentially beneficial transactions. As the OFT notes at paragraph 2.49 of the consultation document, essentially benign or pro-competitive transactions should not be deterred by merger control.

Although the draft guidance provides welcome clarity on a number of issues, the operation of the exceptions to the OFT's duty to refer, particularly with respect to markets of insufficient importance, remains potentially uncertain in practice. This is largely due to the aim of assessing the potential anticompetitive effects of a merger in some detail, as well as the projected consumer detriment and loss of deterrence if a merger is approved, to enable a balancing exercise to be undertaken. Proof of market size (rather than the parties' turnover) may also be difficult in some cases, at least without significant additional inquiry, due to the potential uncertainty of market definition and the difficulty of assessing rivals' revenues. Whilst the burden on the parties to demonstrate to the OFT that the relevant requirements are met may well be less than the burden of a full Competition Commission ('CC') investigation, it is nevertheless significant. As a result, material uncertainty and cost exposure will remain.

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Ultimately, a degree of discretion, and thus unpredictability, appears to be inherent in the statutory framework, including the exceptions to its duty to refer, within which the OFT must operate. Since the utility of an exception is diminished by its unpredictability, a clearer cut safe harbour for small mergers (whether in terms of the markets concerned or the size of the parties involved) remains desirable. We accept, however, that changes to the merger control thresholds themselves (whether through primary or secondary legislation) may be required before this can be achieved.

QUESTIONS

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?

This appears to be a reasonable basis on which to apply the discretion. It can throw up certain difficulties in practice, however, due to the need thoroughly to investigate a transaction before the relevant costs and benefits can be assessed. One way of avoiding such difficulties in the smallest transactions would be to provide a more clearly defined safe harbour, for example by simply ruling out referral of transactions that affect markets with a size of less than £3 million, irrespective of the potential availability of undertakings in lieu.

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?

We do not agree with this. The costs imposed on merging parties by a reference are real and substantial. Unlike the costs to the public purse, which we assume are largely made up of fixed establishment costs that would be incurred whether a referral takes place or not, the costs to merging parties represent a diversion of resources (whether financial or human) from other, potentially more productive, purposes. The prospects of such costs, and uncertainty over their extent, may lead to smaller transactions not happening at all. It would seem to be good public policy to seek to avoid the imposition of such costs, particularly on the parties to small mergers, and we would argue that this is likely to have been the intention behind the statutory provisions concerned. As a result, we would suggest a total welfare assessment is more appropriate when applying this exception. Even if a consumer welfare approach is preferred, it should be borne in mind that the costs incurred by merging parties may ultimately be passed on to consumers, in the event that parties seek to recover those costs through their pricing.

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?

It is not immediately clear to us why the OFT should take the position that consideration of the potential availability of undertakings in lieu should precede any consideration of whether the *de minimis* exception is available. If the markets affected by a transaction are insufficiently important to justify a reference, then this will be the case irrespective of whether any competition issues that do arise on those markets could be remedied by an undertaking in lieu. The key priority should, we suggest, be to ensure that the merger control regime imposes a proportionate burden on businesses, rather than to maintain the presumed deterrent effect of undertakings in lieu as a policy instrument.

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?***

We agree that it should generally be possible to assess, as a matter of principle, whether potential concerns arising from a transaction could be addressed by appropriate undertakings in lieu, were the parties prepared to offer them. As indicated above, however, we suggest that this step - which may turn out to be largely theoretical if the parties are not minded to offer remedies – may be surplus to requirements where the *de minimis* exception is available.

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

Although we can understand the logic of seeking to assess the deterrent effect of references when considering whether to apply the *de minimis* exception, this does present significant difficulties in practice. Specifically, it may require a high level of speculation to assess the loss of deterrence arising from a clearance of a potentially anticompetitive merger on *de minimis* grounds in any individual case. The potential for unpredictability and subjectivity in such an exercise is clear. As a result, we suggest that this should not be a significant part of the OFT's considerations in practice.

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?***

While the rationale behind a merger may have some relevance, for example in the identification of a theory of harm, we do not consider that it should be considered when assessing the potential loss of deterrence arising from clearance of a merger on *de minimis* grounds. In the first instance, the rationale behind a merger (as opposed to its likely effects) is a subjective element that could be prone to misinterpretation by the OFT. In addition, if a potentially anticompetitive rationale is behind a merger but is not publicly stated, it is hard to see how a decision to allow such a merger could reduce the deterrence of future mergers that may have a similar (unstated) rationale.

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?***

While such a situation should not be ruled out, we would suggest that the OFT should, wherever possible, place greater weight on the immediate needs and interests of the merging parties in completing a transaction without incurring further costs than on the potential precedent value of a referral.

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?***

Given the statutory wording governing exercise of this discretion, we are not aware of any such mechanisms.

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?***

We see no appreciable concerns with such an approach, provided that the OFT remains willing to leave open the question of whether its duty to refer is met in appropriate cases.

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?***

We consider that the level of detail is appropriate.

Questions about arrangements insufficiently far advanced/ insufficiently likely to proceed

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?***

We are not aware of any such situations.

Questions about customer benefits

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

The evidential standard applied appears appropriate.

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?***

We would rather not speculate on the reasons for this.

Questions about undertakings in lieu

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?***

We would suggest that the OFT is better placed than we are to assess this.

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?

While we agree that this risk is present, and is to a degree inherent in the OFT's role as a first phase investigator, we consider that it is acceptable, provided that the OFT carries out its investigations properly and that parties are not put under undue pressure to offer undertakings.

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

We would suggest that, in most cases, a simple confirmation to the OFT that the parties have abandoned the transaction should be sufficient to enable the OFT to decide not to make a reference. This would mirror the CC's approach of closing an inquiry if, following a reference, the parties indicate that the transaction in question has been abandoned.

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

Provided that the parties are prepared to offer a divestment, and that divestment addresses the OFT's concerns, we agree that the OFT need not consider its proportionality, in the context of the wider transaction.

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

Although we acknowledge that the wording of section 73(2) Enterprise Act 2002 explicitly refers to the taking of undertakings from the "parties concerned", it would seem to be desirable for purely practical reasons in certain cases to obtain assurances from the purchaser of divestment assets, for example as to its intentions with respect to those assets. We would suggest that the scope of section 73(2) need not be an absolute block to the seeking and obtaining of such assurances, given that even informal undertakings may be viewed as binding in practice by the party giving them.

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

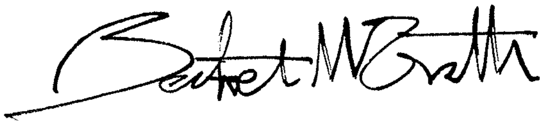
Such assurances may be justified, for example, where the assets could be used for a range of purposes, only one of which would address the OFT's concerns. As a further example, retention and utilisation of the assets in question by the initial purchaser for a specified period could be necessary for the success of the remedy.

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?

Properly applied, we consider that the OFT's approach is proportionate, particularly given the explicit acknowledgment that a 'partial upfront buyer solution' may be acceptable in some cases.

We trust that the OFT finds the above comments helpful and look forward to reading the final guidance document.

Yours sincerely



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