

**RESPONSE TO**

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**Mergers – Exceptions to the duty to refer and  
undertakings in lieu**

**Draft guidance consultation document, October 2009**

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**21 January 2010**



**RESPONSE TO MERGERS – EXCEPTIONS TO THE DUTY TO REFER  
AND UNDERTAKINGS IN LIEU  
DRAFT GUIDANCE CONSULTATION DOCUMENT, OCTOBER 2009**

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## 1. INTRODUCTION AND SUMMARY

1.1 Freshfields Bruckhaus Deringer LLP welcomes the opportunity to comment on the OFT's "*Mergers – Exceptions to the duty to refer and undertakings in lieu, draft guidance consultation*" (the **Draft Guidance**). Our comments are based on our extensive experience of representing clients in merger control reviews throughout Europe, the US and Asia.

1.1 We have not sought to comment on every question raised in the Draft Guidance but have confined our comments to those issues on which we have particular concerns.

1.2 We welcome the publication of clear guidance on how the OFT interprets and applies the merger control regime under the Enterprise Act 2002 (the *Act*). As a general comment, we believe that the OFT should be aiming for such guidance to be as clear and practical as possible, in order for all businesses (and their advisers) to understand how the regime is likely to apply to their deals. We suggest that clearer guidance also delivers indirect benefits to consumer welfare by more effectively deterring parties from pursuing anti-competitive mergers.

1.3 We are concerned that there are a number of areas in the Draft Guidance where the application of the rules in practice may not be entirely clear to business, particularly those that are not regularly involved in UK merger control procedures. Clarity is even more important in guidance such as this which focuses on how the rules apply to small mergers in which the costs to undertakings of the regulatory process may constitute a significant proportion of the overall transaction value. In particular, as currently drafted, we do not believe that the description of the market size threshold, and the different levels and factors taken into account when deciding whether the "de minimis" threshold should apply, are sufficiently clear to allow effective "self-assessment" by merging parties and their advisers, that such guidance should be designed to encourage. This issue is discussed in more detail below.

## 2. MARKETS OF INSUFFICIENT IMPORTANCE

### The Market Size Threshold

2.1 As stated above, we are concerned that the Draft Guidance does not provide a sufficiently clear explanation of how the £10 million threshold works in practice in order for merging parties to understand with any degree of certainty whether or not the exception might apply to their deals.

2.2 In particular, the apparent shift in the OFT's approach to this threshold, as compared with its previous guidance of November 2007 (OFT516b) risks undermining business certainty over the impact of these rules in practice. Compare, for example, the statement that "*below the £10 million market size threshold, the OFT would generally consider the market to be of insufficient importance to justify a reference*" (OFT516b, paragraph 7.6) with the Draft Guidance's assertion that "*it does not follow that where the aggregate size of the affected market(s) is below £10 million the exception will generally be applied or is even likely to be applied*" (paragraph 2.15). The OFT now appears - without any justification other than its use

in a specific case - to have established £3 million as the market size at which “*the OFT would expect the ‘de minimis’ exception generally to apply*” (paragraph 2.14). If there has been such an important change in the OFT’s approach – as the Draft Guidance currently indicates – this should be fully explained by the OFT’s reference to a body of experience showing how application of the existing guidance over the past two years has led to adverse effects on competition and/or consumer welfare.

2.3 However, if the OFT’s approach to the market size threshold has not in fact changed, we believe that (both in the Draft Guidance and in future cases) the OFT should be seen to be clearly applying the £10 million threshold, except in very exceptional (and clearly explained) cases. Otherwise, there is a risk that the value of the threshold in terms of facilitating an efficient use of resources in the UK’s merger control regime is undermined.

2.4 On the understanding that the OFT’s approach to the market size threshold has not changed, we recommend that the lower “thresholds” cited in the Draft Guidance<sup>1</sup> should:

- (a) either be removed to improve clarity and certainty; or
- (b) redrafted in order to explain that they are purely indicative examples of where the exception has been used, but should not be interpreted as being additional “thresholds” or as undermining the consistent application of the £10 million threshold.

### **Public costs and private costs**

2.5 We believe that there are good arguments for private costs to be taken into account when assessing the costs of a reference. The Draft Guidance makes clear that the merger control system is based on a “*consumer welfare standard*” (paragraph 2.7). However, costs to business can result in consumer harm just as much as public costs. These private costs include the direct monetary costs of a reference, distractions to management time, and adverse impacts on the undertaking and its employees arising from the commercial uncertainty and stagnation during a reference period<sup>2</sup>.

2.6 It is for this reason that minimising private costs is a legitimate objective in other areas of both competition law and regulation (and is a fundamental objective of the Better Regulation initiative<sup>3</sup>). If the OFT is not minded to take private costs into

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<sup>1</sup> £6 million (“*the OFT has not previously applied the de minimis exception in markets of this size and notes it will be unlikely to do so unless its assessment of the other relevant factors strongly suggest it should do so*”, footnote 6); and £3 million (“*the OFT would expect the ‘de minimis’ exception generally to apply where the size of the affected market(s) is below £3 million...*”, paragraph 2.14).

<sup>2</sup> As recognised in the 2007 report by Deloitte, “... *apart from the direct costs, there may be other negative impacts of a CC reference, such as management distraction, the damaging impact on its employees and relations with customers and suppliers while the business is ‘in limbo’.*” (The deterrent effect of competition enforcement by the OFT, a report prepared for the OFT by Deloitte, paragraph 4.66).

<sup>3</sup> It is the Better Regulation Executive’s express goal “*to remove unnecessary costs and challenge regulation’s potentially negative impacts. In doing so we help create the conditions for business*”

account on a formal basis, this issue further underlines the importance of the OFT applying a sufficiently clear and consistent threshold in the use of the exception for small mergers.

### Interaction between “de minimis” and potential undertakings in lieu

Paras 2.18-2.27

2.7 We note the OFT’s policy that it will not apply the “de minimis” exception where clear-cut remedies are available “*in principle*”. We are concerned that this policy does not appear either sensible or appropriate:

- (a) ***The Legal Test***: as the Guidance expressly acknowledges, the Act is clear on the sequence of events that the OFT must consider in its assessment:
  - (i) first, whether there is a duty to refer;
  - (ii) if yes, whether one of the exceptions should apply; and
  - (iii) if not, whether the OFT should accept undertakings in lieu of a reference.

We believe that the basis for this sequence in the Act, and the OFT’s assessment, is both linguistically and conceptually clear, and the question of whether any of the exceptions apply should be assessed purely on the factors that are relevant for each of those exceptions. The OFT itself states that the question to be considered for the purposes of the “de minimis” exception is whether “*the cost of a reference to the public purse is outweighed by the consumer harm that would result from the merger if the CC were to find a substantial lessening of competition.*” (paragraph 2.1)<sup>4</sup>. This is completely separate from the question as to whether remedies are necessary, appropriate or available. The statutory scheme clearly envisages – as do we - that remedies should only be considered once the OFT has determined that it has a duty to refer and none of the exceptions to that duty apply (in other words, in the case of small mergers, where the consumer harm is sufficient to justify a reference).

- (b) ***Disadvantaging certain types of transaction***: under the current policy, certain types of transaction appear to be disadvantaged. For example, if Merger A involved the acquisition of one medium-sized (but indivisible) business which raises concerns at a local level, but where undertakings are not available in

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*success ... Our fundamental approach is to ensure regulation is only introduced where there is a clear market failure or social equity justification, and that where it is used costs are kept as low as possible.*” (Better Regulation Executive, *Better regulation, better benefits: getting the balance right* (October 2009, page 5).

<sup>4</sup> The (consumer welfare-focused) factors that should rightly be taken into account in this assessment are in fact fully encapsulated in the second of the three issues that the OFT subsequently states it will consider: “*whether the consumer harm potentially resulting from the actual merger under investigation is likely to exceed materially the costs of a reference, taking account of the market size, the magnitude of competition potentially lost, the expectation of harm arising and the duration of any such effects*” (paragraph 2.16). The additional consideration of both undertakings in lieu and deterrence is therefore unnecessary and inappropriate.

principle, those parties may benefit from the “de minimis” exception. However, Merger B, which involves the acquisition of 5 smaller businesses and raises exactly the same competition concerns at a local level, may be required to divest either one or two parts of that business, simply because that business is readily divisible and remedies appear available “in principle”<sup>5</sup>. We believe that such an outcome appears perverse, and runs contrary to the intentions of the Act.

- (c) **“Availability of undertakings in principle”**: the Guidance provides some detail as to how the OFT will undertake its assessment of when undertakings in lieu will be considered available “in principle”. However (and without prejudice to our preference for this “in principle” test to be abandoned), we consider that, if such considerations do continue to be relevant, additional guidance is undoubtedly required. The Guidance does not make clear, among other things, the time at which the OFT will make its assessment, the sources from which it will obtain its evidence, the point at which a potential undertaking in lieu would be considered “tantamount to prohibiting the merger” (paragraph 2.26) (and thus “unavailable”), or the role (if any) which the merging parties should play at this stage of the process. We have serious concerns about the prospect of the OFT reaching an abstract view that remedies are available in principle without due regard to the facts of the underlying transaction.
- (d) **Minimising regulatory costs for certain mergers**: it appears clear that Parliament’s intentions behind introducing the discretion for the OFT to apply an exception to its “duty to refer” for mergers in “markets of insufficient importance” were largely based on avoiding unnecessary and excessive costs in reviewing such deals<sup>6</sup>. These intentions appear to be undermined by the OFT’s policy towards undertakings in lieu in such cases, where the costs of regulatory intervention which are incumbent with the scheme are re-instated. It therefore appears questionable whether the OFT’s policy is consistent with the original intentions behind the exception.

## Vulnerable consumers

Para 2.39

2.8 We note the OFT’s comment that it is likely to place “particular weight on the magnitude of competition lost by the merger where a substantial proportion of the likely detriment is suffered by vulnerable consumers”. We are concerned that this statement risks blurring the boundaries between the objectives of the competition regime and wider public policy objectives. The problems of vulnerable consumers should be directly addressed as part of the normal analysis of a merger’s effects on

<sup>5</sup> “Cases suitable for resolution by undertakings in lieu are typically those where the part of the transaction that raises concerns can be divested to an independent third party purchaser. The “de minimis” exception is therefore unlikely to be applied to this type of case” (paragraph 2.25, Draft Guidance).

<sup>6</sup> “The discretion for the OFT to decide not to refer a merger because the market is of insufficient importance is designed primarily to avoid references being made where the costs involved would be disproportionate to the size of the markets concerned” (paragraph 97 of the Explanatory Notes to the Act).

consumers in the relevant markets; for example, whether the number of alternative products to which a vulnerable consumer could switch is smaller for a particular reason.

Paras 2.43-2.51

## **Deterrence in Merger Control**

2.9 We have concerns about the OFT's proposal to apply the merger control regime in a way that individual decisions could be taken with a view to deterring future mergers. We believe that the role of merger control is to assess each transaction on its own merits and that the issue as to whether the outcome of that assessment may encourage or deter future mergers in the same, or similar, sectors is an irrelevant consideration.

2.10 As with the issue of undertakings in lieu discussed above, the inclusion in the OFT's assessment of such extraneous factors, goes beyond an assessment of "*the consumer harm that would result from the merger if the CC were to find a substantial lessening of competition*", and adds further complexity to attempts at "self-assessment" by undertakings. It is undesirable that an undertaking could be disadvantaged on the basis of hypothetical transactions that (the OFT believes) wholly unconnected third party competitors may or may not enter into in the future.

2.11 This policy appears to be trying to avoid some of the problems inherent in a voluntary regime (i.e. potentially anticompetitive mergers not being notified to the OFT and failing to be assessed). However, that problem is properly addressed by the effective use of the OFT's Mergers Intelligence Function and through a transparent and predictable merger control policy through the use of clear guidance and decision-making.

2.12 Moreover, if the OFT is concerned that the use of the "de minimis" exception may encourage similar mergers that would not benefit from the exception, that concern should be addressed by use of clear wording in its decisions (for example: "*The use of the exception in this case should not be interpreted as meaning the exception will be applied in other similar transactions [in this market/sector]. Each such merger will be assessed on its own merits*"). This approach would be particularly appropriate if the OFT's concern primarily relates to one or two markets or sectors, rather than seeking to disapply the exception generally.

## **3. UNDERTAKINGS IN LIEU OF REFERENCE**

Paras 5.35-5.41

### **Upfront Buyers**

3.1 We are concerned that the Draft Guidance indicates a hardening of approach in the use of upfront buyers without any clear explanation as to why the OFT's policy should be changing.

3.2 The use of upfront buyers frequently involves serious timetable implications and commercial difficulties for the parties involved. An increased use of this mechanism risks certain mergers either not being pursued or the undertakings in lieu procedure becoming less attractive to parties (compared to a Competition Commission reference, and the additional time for assessment and discussion on

appropriate remedies that such a reference provides). We believe that these practical implications should be fully taken into account in the OFT's on-going policy towards the use of upfront buyers and that any change in policy (which is not temporary and directly linked to the current economic conditions) should be fully explained in the Draft Guidance.

#### **4. CONCLUDING REMARKS**

4.1 By way of conclusion, we emphasise that businesses and their advisors benefit from, and rely upon, clear and consistently applied guidance. We therefore very much welcome publication of such guidance by the OFT. However, we are concerned that, as currently drafted, some sections in the Draft Guidance risk replacing existing guidelines with ones which are more uncertain, harder to apply, and which take account of factors that go beyond the primary impact of a transaction on consumer welfare and competition.

4.2 If the OFT wishes to discuss any of the points made in this response, please contact Simon Priddis (020 7832 7259) or Sarah Jensen (020 7832 7092).



**FRESHFIELDS BRUCKHAUS DERINGER**

**21 January 2010**