

**JOINT WORKING PARTY OF THE BARS AND LAW SOCIETIES OF THE
UNITED KINGDOM ON COMPETITION LAW**

**MERGERS - EXCEPTIONS TO THE DUTY TO REFER
AND UNDERTAKINGS IN LIEU**

OFT's DRAFT GUIDANCE CONSULTATION DOCUMENT

January 2010

1. INTRODUCTION

- 1.1 The OFT has issued a Consultation Document¹ on the text of revised OFT guidance on the exceptions to its duty to refer to the Competition Commission (CC) and its ability to accept undertakings in lieu of reference to the CC (UILs).
- 1.2 The JWP² was pleased to have the opportunity to discuss issues arising on the Consultation Document at a meeting with OFT representatives on 7 December 2009³ and welcomes this opportunity to submit written comments to the OFT.
- 1.3 The JWP first sets out its comments on what it views as the most important issues raised in the Consultation Document. The JWP then responds briefly to each of the specific questions posed in the Consultation Document.

2. KEY ISSUES

- 2.1 The comments of the JWP focus on four main issues raised by the Consultation Document, namely: (A) the thresholds in the '*de minimis*' guidance; (B) the use of "deterrence" in the merger control regime; (C) the Dunfermline Press approach to the relationship between the '*de minimis*' exception and the availability of UILs; and (D) the OFT's proposal to make increased use of a requirement for upfront buyers in divestment undertakings. The JWP comments on each of these below.

2A. Market size thresholds

- 2.2 The draft guidance mentions three figures - £10 million, £6 million and £3 million; £10 million is the "upper threshold, £3 million the "lower" threshold.
- 2.3 The JWP notes that in the current '*de minimis*' guidance⁴, the OFT states that "*below the £10 million threshold, the OFT would generally consider the market to be of insufficient importance to justify a reference*". The revised draft guidance uses the £10 million threshold in a very different way. It states that the OFT will generally regard

¹ Mergers - Exceptions to the duty to refer and undertakings in lieu, Draft guidance consultation document, October 2009, OFT1122con.

² The members of the Joint Working Party of the Bars and Law Societies of the United Kingdom on Competition Law comprises barristers, advocates and solicitors from all three UK jurisdictions; the membership includes both those in private practice and in-house. Its secretary is Louise Speke of the Law Society, 113 Chancery Lane, London WC2A 1PL (telephone: 020 7242 1222).

³ This was a joint meeting involving also members of the City of London Law Society Competition Law Committee.

⁴ Revision to *Mergers – substantive assessment guidance: Exceptions to the duty to refer: markets of insufficient importance* OFT 516b November 2007 (para 7.6)

an affected market to be of sufficient importance to justify a reference (and the '*de minimis*' exception will not apply) if it has a value of more than £10 million; and goes on to state that the OFT will "generally" apply the '*de minimis*' exception where the market size is below £3 million. Thus, in effect, the revised draft guidance drops the '*de minimis*' presumption from £10 million to £3 million. This is a major change in policy and practice. The JWP recognises that the change may be justified on the basis of the OFT's decisional practice to date. However, this is not clearly stated in the Consultation Paper and the JWP considers that, if this is indeed the justification for the change, it should be spelt out more clearly.

- 2.4 The "indicative" threshold of £10 million is said to derived from a calculation based on a hypothetical scenario and a number of factual assumptions (per footnote 5 of the draft guidance). This may have been appropriate originally, when the OFT did not have any experience of applying the '*de minimis*' exception. However, the OFT now has experience of doing so: in practice the OFT has never applied the '*de minimis*' exception where the market size was £10 million or more -- and, per footnote 6, the OFT has applied it only once where the market size was around £6 million. The JWP considers that it would be more appropriate for the guidance now to justify the £10 million threshold primarily by reference to the OFT's experience to date, rather than by reference to the rather contrived calculation and assumptions set out in footnote 5. Some reference to that calculation could be retained (as a footnote) if it was thought to be necessary to indicate the historical justification for the figure of £10 million.
- 2.5 The JWP understands that the reference to £6 million (in footnote 6), together with the language from the OFT's decision of May 2009 in *Stagecoach*, is included in order to provide additional guidance. There is a view that its inclusion in fact causes a degree of confusion and lack of clarity. The JWP considers that, to provide the additional guidance intended, the document needs to contain a clearer explanation of the relationship between the figures of £6 million and £10 million; and that it would be better not to bury the figure of £6 million (and accompanying language) in a footnote as is presently the case, but to include it in the main text and to use it to amplify the explanation of the £10 million threshold.
- 2.6 The JWP suggests that such guidance might state, for example, that: *"Based on its experience to date, the OFT has difficulty envisaging a set of circumstances where it would be appropriate to apply the 'de minimis' exception if the market size were £10 million or more. Indeed, to date, the highest value of a market to which the OFT has applied the 'de minimis' exception is around £6 million and it has done that only once⁵. In practice, the larger the value of the market concerned, the less likely it is that the OFT will apply the 'de minimis' exception and the greater will be the requirement to show the strength of other relevant factors suggesting that the OFT should do so"*.
- 2.7 The JWP accepts that the OFT may have legitimate concerns about the legality of specifying a (lower) threshold below which it would always apply the '*de minimis*' exception (i.e. a "safe harbour") -- since this might be argued to be an unlawful fetter

⁵ Insert appropriate reference to the OFT's decision of 13 May 2009 on *Stagecoach*.

on the exercise of its discretion⁶. That said, the JWP is of the view that the OFT should avoid using language that risks diminishing the clarity of the statement in the guidance that the OFT will "generally" apply the 'de minimis' exception where the market size is below £3 million -- especially as this figure will in effect have been reduced by the OFT from the figure of £10 million in the current guidance. In this regard, the "without prejudice" language proposed in relation to the threshold is unhelpful and unduly strong. The JWP suggests that the OFT use wording along the following lines in place of the current "without prejudice" language: *"Only a very exceptional factual matrix would cause the OFT to refer a merger to the CC where the market size is below £3 million."*

2B. Deterrence multiplier

- 2.8 The JWP acknowledges that the UK merger control regime has a deterrent effect. This arises mainly as a consequence of the ability of the OFT to refer a merger to the CC and the power of the CC to order divestiture in the case of a completed merger (or to impose other remedies). The JWP also acknowledges that it is a legitimate policy objective -- especially given the "voluntary" nature of the UK regime -- for the OFT to seek to deter parties from entering into genuinely anti-competitive mergers without informing the OFT, in the hope that the OFT will not find out about such mergers, investigate them and refer them to the CC. However, steps to deter such mergers must be proportionate, especially mergers having minimal impact on consumers.
- 2.9 The OFT appears to consider that "deterrence" is a particularly important factor in the situation outlined in paragraph 2.51 of the draft guidance -- where *"the merger in question is one of a potentially large number of similar mergers that could be replicated across the sector in question. Although the affected market in each merger might otherwise be regarded as 'de minimis' taken on its own, the amount of consumer harm that could result from similar consolidation across the entire sector might well be considerable. Such consolidation should therefore properly be deterred by the mergers regime"*.
- 2.10 The JWP does not accept that, when looking at a particular merger, it is correct for the OFT to take into account the potential for a number of similar mergers in the sector in question and the need to "deter" similar mergers. The JWP considers that, in principle, the OFT should consider each merger individually on its own merits and that, when assessing each individual merger, the OFT should do so by reference to historic and current conditions of competition -- not by reference to a possible further merger in the sector in future and an assumption that such a merger would be unacceptable. The JWP considers that it is not appropriate for the OFT to adopt a policy based on the anticipation of future mergers -- which may or may not occur and the effects of which cannot be assessed.
- 2.11 It follows that the JWP does not support the proposed use of a "deterrence multiplier"

⁶ The same might be argued if the OFT were to specify an (upper) threshold above which it would never apply the 'de minimis' exception (although the implications of this are of less concern for enforcement policy).

- 2.12 To the extent that the JWP's approach (i.e. of considering each merger individually on its merits) might give rise to OFT concerns of the kind described in the draft guidance, the JWP suggests that it be addressed in the OFT's guidance in a different, more proportionate manner. The guidance could be amended to make it clear that a decision by the OFT to apply the '*de minimis*' exception to a particular merger should not be taken as implying that the OFT would be likely to apply its discretion in a similar way in relation to any other merger, even if the factual matrix might appear very similar; and that this is especially true in the case of a merger where the effect of another such merger (or mergers) in an industry or sector might result in a degree of consolidation the aggregate effects of which might raise more serious issues about possible consumer harm. It would even be possible for the OFT to include a statement to similar effect in any decision where it considered that the application of the '*de minimis*' exception might give rise to a concern of this kind (or in the press release accompanying the OFT's decision).
- 2.13 In any event, it is not entirely clear to the JWP what situation the OFT is contemplating in paragraph 2.51. The reference to replication of similar mergers across the "*entire sector*" suggests to the JWP that the OFT is thinking of sectors consisting of a series of geographically localised markets. In the view of the JWP, the right approach here would be, first, to consider whether the markets are properly defined as separate local markets, and, if so, to treat each market separately. Secondly, to the extent that there may come a stage in the consolidation of a particular industry when there could, in addition, be some form of "national market overlay", that should only be considered as and when it becomes an issue. It would not be right, in the view of the JWP, for the OFT to decline to apply the '*de minimis*' exception to a merger at a stage in the consolidation of a particular sector or industry before that point was reached. It is a fact of commercial life (which is not generally a matter warranting regulatory interference) that there can be a "first mover" advantage in consolidation within a single market, and the same principle should apply where markets are essentially local but there may come a point at which "wider-than- local" issues arise.
- 2.14 It occurs to the JWP that the situation described in paragraph 2.51 of the draft guidance may be the one that the OFT has in mind when it refers in paragraph 2.14 to a "*factual matrix*" that may cause it to refer a merger to the CC where the market size is below £3 million. If so, and (contrary to the views of the JWP), the OFT maintains the approach outlined in paragraph 2.51, the JWP considers that paragraph 2.51 could usefully be clarified and that any relation between paragraphs 2.14 and 2.51 be made clear.

2C. The OFT's Dunfermline Press approach

- 2.15 The draft guidance recognises that the Act sets out the sequence of the questions that the OFT must ask itself in relation to the acceptance of undertakings in lieu of reference (UILs):
- First the OFT must consider whether it is under a duty to make a reference to the CC;

- If it is, the OFT must then decide whether to apply certain exceptions to the duty to refer, including the '*de minimis*' discretion; and
 - Only if the OFT decides not to apply any available exception (such that it would otherwise actually make a reference), may the OFT then accept UILs.
- 2.16 The draft guidance suggests "*that the Act leaves open to the OFT the considerations it should take into account in exercising its 'de minimis' discretion. Consequently, it is open to the OFT, when exercising its 'de minimis' discretion, to have regard to all relevant considerations, including whether the potential consumer harm in the case in question could have been avoided by the provision of clear-cut undertakings in lieu*".
- 2.17 The JWP does not share the OFT's apparent certainty about the manner in which the Act should be interpreted on this point. In the view of the JWP, it is clearly arguable that, since the Act envisages a particular sequence for considering these issues, it is not open to the OFT, in effect, to circumvent the sequence laid down in the Act -- by considering whether potential consumer harm could be avoided by means of a clear-cut UIL in the course of deciding whether or not to exercise its '*de minimis*' discretion.
- 2.18 In addition to its concerns about the questionable legality of the OFT's Dunfermline Press approach, the JWP does not consider this approach to be correct as a matter of policy. It leads to an inconsistency which, in the view of the JWP, has no policy justification. This is illustrated by the following example:
- Company A supplies widgets and blodgets. Company B supplies widgets, nuts and bolts. B's widget business is separate from its nuts and bolts business. Assume that (i) widgets is a separate market from nuts and bolts, (ii) the combined position of Companies A and B in the widgets market would satisfy the "duty to make a reference" test and (iii) widgets is sufficiently small to be a candidate market for exercise of the '*de minimis*' discretion. The Dunfermline Press approach, as stated in the draft guidance (paragraph 2.21), would, as a matter of "*general policy*" mean that the availability of a clear-cut remedy denies the parties the possibility of benefiting from the exercise of the '*de minimis*' discretion.
 - Now compare the situation where the same facts are exactly the same except that Company B supplies only widgets. Here the OFT indicates (at paragraph 2.26) that it will not consider that UILs are in principle available – because to accept undertakings "*would be tantamount to prohibiting the merger altogether*". Therefore there would not be any bar to the exercise of the '*de minimis*' discretion.
- 2.19 As the example illustrates, a company that purchases a single (problem) market business in a small market has better prospects at the OFT stage than a company purchasing the same business when part of a wider conglomerate. The competition

issue is identical in both cases and the JWP considers it to be wrong, as a matter of policy, for the OFT to distinguish between the two situations⁷.

- 2.20 Consequently on both legal and policy grounds the JWP considers that the OFT should reconsider its use of the Dunfermline Press approach.

2D. Increased requirement for up front buyers

- 2.21 In circumstances where there is a serious risk of there being no purchaser at all in the context of divestment undertakings, the JWP acknowledges that it is appropriate for the OFT to consider requiring use of an upfront buyer in order to ensure that the undertakings are effective in achieving their objective.
- 2.22 That said, the JWP is concerned that the wording proposed in the draft guidance erects a large number of hurdles for merging parties. Moreover, the height of those hurdles is uncertain because the guidance uses⁸ ill-defined terms (i.e. “material”, “suitable”, “high”, “swift”) so as to give the OFT very wide discretion when setting the height of the hurdles and allow it to vary the height on a case by case basis. The JWP is concerned that, in practice, this could allow the OFT to require an upfront buyer in an unduly large number of cases. The JWP considers that a policy change of such magnitude is not justified on the basis of current experience⁹.
- 2.23 The OFT will appreciate that the upfront mechanism can have a significant impact on timing in Phase I. For that reason, and for more general policy reasons, the JWP considers that the OFT should limit use of the mechanism to circumstances where there are very real and substantial doubts about the availability of candidate purchasers, and not adopt an approach where it is so difficult for merging parties to meet the hurdles erected by the OFT that, in effect, requiring an up front purchaser becomes the accepted norm.
- 2.24 This requires a change to the language in the current draft. The JWP suggests that the initial onus should be on the OFT to show that reasonable doubts exist with regard to, for example, the ongoing viability of the divestment package or the number of candidate suitable purchasers (see paragraph 5.38 of the draft guidance). The burden would then shift to the merging parties to persuade the OFT that *“there are no reasonable grounds for such doubts, having regard to the number and suitability of potential purchasers for the divestment business (or for each of the divestment businesses) and the likelihood of a successful sale being agreed and completed in a timely manner following acceptance of undertakings in lieu”*. The JWP considers that this would be a more proportionate approach than the one proposed in paragraph 5.40.

⁷ The JWP agrees that for anticipated mergers, an undertaking to divest the very business proposed to be purchased would not be meaningful. However, an undertaking of that kind for a completed merger is a different matter and should be possible – see the JWP’s response to Q19.

⁸ In this context, see paragraph 5.40 of the draft guidance in particular.

⁹ The JWP warns against the circumstances of *Sports Direct* unduly influencing the OFT’s approach to this issue.

3. JWP RESPONSES TO SPECIFIC OFT 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?

The JWP considers this to be a reasonable approach.

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?

The JWP agrees that public costs should generally be the determining factor.

That said, the JWP suggests that, in appropriate cases, account should also be taken of indirect consumer harm that a reference may cause, for example, where market uncertainties may affect the business of the target and the willingness of third parties to contract with it during the period of the reference.

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?

The JWP does not consider the OFT's approach to be appropriate on either legal or policy grounds – see also Section 2C above.

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?

As mentioned above, the JWP does not consider the Dunfermline Press approach to be appropriate.

If, contrary to this view, the OFT decides to maintain this policy position, the JWP welcomes the OFT's indication that it will adopt a conservative approach when assessing whether or not UILs are "in principle" available, particularly given the potential implications for merging parties. The JWP would, however, welcome further guidance on:

- how the OFT will factor the possibility of an upfront buyer requirement into its consideration of whether divestment undertakings are "in principle" available;
- how far the OFT will go in its consideration of the "in principle" availability of undertakings – for example, will the OFT regard UILs as being available "in principle" where the parties could offer a clear cut remedy but only by divesting more than the activities that give rise to the competition concern?

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

The JWP does not agree that deterrence is an appropriate factor for the OFT to take into account when considering whether to apply its 'de minimis' discretion – see Section 2B above. The JWP considers that, in principle, each merger should be considered on its merits without regard to the potential "deterrent" effect.

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?

No – having regard to the JWP's views about deterrence generally – see Section 2B above.

Moreover, the JWP is uncertain how the OFT would propose to discover the economic rationale behind a particular merger. Is this likely to increase the evidential burden on the parties or is it simply a question of the OFT's reviewing the relevant board papers etc for a "smoking gun" which reveals this rationale and/or (as in footnote 32 of the draft guidance) assessing customer reaction to a merger which would be part of its substantive assessment of whether there was an SLC in any event?

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 that this caveat should be retained?

No. In the view of the JWP it would not be appropriate to refer a merger on these grounds. Accordingly it is appropriate to remove this caveat from the guidance.

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. That said, the JWP is doubtful about the scope for significantly reducing costs via the third measure given that the decision to apply the 'de minimis' exception seems to be taken towards the end of the review process.

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?

The JWP has no comments on this.

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?

In principle, the JWP considers that this should be permitted. The JWP has identified one possible concern – namely the potential for this adversely to affect the position of the parties in relation to a subsequent reference of the merger to the Competition Commission, following a successful challenge, before the Competition Appeal Tribunal, of the OFT's decision to apply the exception. It will be important to ensure that any such waiver is drafted in a manner that does not effectively constitute a concession/admission that the merger gives rise to an SLC such that the parties are inhibited in their submissions to the Competition Commission.

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?

The JWP has no comments on this.

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?

The JWP has no comments on this.

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?

The JWP does not perceive any obvious shortcomings in the approach suggested in the above Questions (13, 14 and 15). That said, as the OFT has yet to apply the customer benefits exception, there is no practical experience of this exception to inform the JWP's views.

Q16 Why have parties been unable to substantiate a customer benefits exception at phase one under the Act to date?

The JWP suggests that one reason may be because the OFT has traditionally been perceived as rather sceptical about reliance on such arguments resulting in a view that only in the most exceptional of cases would such benefits be likely to secure a Phase 1 clearance. It may also be the case that no such mergers have yet occurred.

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?

The JWP considers that the OFT should be willing to accept a mitigatory remedy only in the circumstances identified in paragraph 5.16 of the draft guidance.

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?

No. An offer of UILs is a voluntary process and it is for the parties to decide how far they are prepared to go to avoid a reference.

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

Yes.

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

Yes. Again it is for the parties to decide how far they are prepared to go to avoid a reference.

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

Yes.

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

The JWP is of the view that if the OFT is considering the need to seek informal ongoing behavioural commitments from a potential purchaser, it is likely to be doing so because of concerns about the purchaser that should make it think very carefully about whether that

purchaser is, in fact, a suitable buyer of the assets or business in question. The JWP is not aware of circumstances in which the OFT should seek such commitments.

The JWP notes that in footnote 74, the OFT explains that it will normally require the selling merging party to require from the divestment purchaser a warranty reflecting the obligation set out in the third bullet of paragraph 5.30 of the draft guidance. The JWP queries what purpose this warranty serves as it is not directly enforceable by the OFT.

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?

See Section 2D above.

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