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15 January 2010

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For the attention of Nicholas Scola

Our ref. HACIASE

Your ref.

By Email

Dear Sir

Consultation on draft guidance on exceptions to the duty to refer and undertakings in lieu

Olswang welcomes the opportunity to comment on the OFT's draft guidance on exceptions to the duty to refer and undertakings in lieu (OFT 1122con) (the "Draft Guidance"). Further clarification of the OFT's practice and policy in relation to the application of its discretion in this area is welcome. For ease of reference we have responded to each of the specific questions set out in Annex A of the Draft Guidance in the Annex to this letter. In addition to these responses, in light of our experience applying the OFT's current guidance we have a number of comments on the Draft Guidance.

In particular, we consider that the sections which describe how the OFT applies the discretionary exceptions to the duty to refer and how it will exercise its ability not to refer if it accepts undertakings in lieu of reference to the Competition Commission ("CC") could be amended in order to provide more focussed and practical guidance to stakeholders.

Application of the de minimis exception

1. Notwithstanding that the Draft Guidance is, in principle, beneficial for merging parties and their advisors to assess whether the OFT is likely to apply one of the discretionary exceptions to the duty to refer, the Draft Guidance does not sufficiently improve predictability for potential purchasers of businesses which qualify as relevant merger situations. The OFT recognises the "*value of predictability*" for stakeholders (at paragraph 2.11) and yet the Draft Guidance does not significantly improve

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stakeholders' understanding of the OFT's approach (which can be gleaned from the OFT's current guidance (OFT 516 and 516b) and the OFT's practice).

2. If the OFT adopts the Draft Guidance, assessing the way in which the OFT is likely to apply its discretion will be even more complicated. We are disappointed that the Draft Guidance effectively reduces the size of market threshold from £10m and has complicated matters further by introducing four different categories:

(i) above £10m: The OFT will "generally" refer (paragraph 2.2). Although the OFT has indicated it may consider the exception in cases where the market size only marginally exceeds £10m these cases will be extremely rare if the OFT is unlikely to apply the exception to markets valued at over £6m;

(ii) between £6m - £10m: Where a market is valued at more than £6m the OFT is "unlikely" to apply the exception unless there are additional factors which strongly suggest it should do so;

(iii) between £3m - £6m: The OFT will consider applying the de minimis exception; and

(iv) below £3m: The OFT will generally apply the exception (paragraph 2.14).

3. The £10m size of market threshold was widely welcomed when introduced in November 2007 as a reasonable threshold for determining whether a merger might fall within the de minimis exception. Whilst the OFT has, since the introduction of this £10m threshold, shown a greater willingness to apply its discretion where the affected markets are significantly below this threshold, it was still possible that the OFT would apply the exception as long as the £10m threshold was not exceeded. However, the OFT would now be "*unlikely*" to do so if the value of the market is above £6m.
4. We consider this to be a backward step. In practice, the OFT has reduced the de minimis threshold to £6m in all but exceptional circumstances. As noted in our response to Question 2, we consider that the costs which the OFT takes into consideration ought to include those incurred by private parties. If this were the case, the threshold would be greater and more representative of the costs of a CC investigation.

Undertakings in lieu of reference guidance

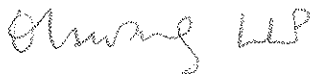
5. Our key concern in relation to the OFT's Draft Guidance is the OFT's emphasis on the use of the "upfront buyer" mechanism. The OFT has used this mechanism in an increasing number of cases over the past two years. As noted in our response to Question 23, the majority of purchasers would prefer to give an upfront buyer undertaking in lieu of reference rather than face a CC investigation but this represents

an acceptance of a "least worst" option rather than an approach that should be used in anything other than highly exceptional cases.

6. The OFT has sufficient powers under section 75(4) of the Enterprise Act in order to address breaches of undertakings in lieu (although, in practice, the OFT has shown reticence to use these powers). Whilst the OFT might consider the use of the upfront buyer mechanism to be proportionate in cases where the parties may struggle to find a suitable purchaser for a divestment business, we consider that this leads to disproportionate pressure on purchasers.
7. In light of these pressures, we consider that the use of the upfront buyer mechanism ought to be reserved for circumstances where there is an exceptionally high likelihood of not finding a suitable purchaser or where the parties involved have been un-cooperative in fulfilling undertakings in previous cases.

We would be happy to discuss any of the points raised in this letter.

Yours faithfully

A handwritten signature in cursive script, appearing to read "Olswang LLP".

OLSWANG LLP

ANNEX

RESPONSE TO THE OFT'S QUESTIONS

Questions about markets of insufficient importance
<i>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?</i>
<p>To some extent this is a reasonable approach. However, the main drawback with this approach is that there is little real certainty for purchasers that a deal will not merit investigation by the OFT notwithstanding its small size. Paragraph 2.13 of the draft guidance states that "Given the cost/benefit approach adopted by the OFT, it is not possible to identify a firm 'safe harbour' in terms of market size below which the de minimis' exception will always be applied." A radical approach might be to apply the "de minimis" exception on the basis of the total market size or value of the transaction and draft guidance on the basis of a threshold which would be transparent for all potential purchasers.</p>
<i>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?</i>
<p>In our view, the OFT should also take into account private costs. We agree (as the OFT points out at paragraph 2.7) that purchasers are generally aware of the potential costs associated with an acquisition and subsequent authority investigations and, where a merger is likely to raise substantive competition issues, can seek to negotiate with vendors to make the deal conditional on OFT clearance. However, the costs likely to be incurred by merging parties during an investigation by the CC (in particular management time and legal fees) are significant. The costs incurred by the parties and the lengthy time it takes for an investigation by the CC (and, where necessary, for remedies to be agreed) are likely to have a negative impact on the businesses involved and customers may well have a reduced quality of service and/or increased prices as a result. The potential negative impact will be even more acute where the businesses affected are in a sector which is already under pressure due to the economic downturn. Therefore, we consider that the OFT should take into account additional private costs in determining the true cost of a reference in addition to the costs incurred by the CC.</p>
<i>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?</i>
<p>Yes.</p>

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?

Yes. However, we consider the guidance should state that the OFT will apply a proportionality test when considering if "clear-cut" undertakings are available rather than the "conservative approach" as drafted under para 2.27. Applying a "proportionality test", the de minimis exception would not be available if the OFT considered clear-cut undertakings to be proportionate to the competition concerns initially identified. Conversely, the de minimis exception would still be available if the OFT considered clear-cut undertakings to be disproportionate in the circumstances.

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

Yes. It is appropriate for the OFT to consider whether a merger has an anti-competitive rationale. However, we agree that it is not appropriate to apply a standard deterrence multiplier to every case (para 2.49).

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?

Yes. Particularly in the current climate, acquisitions may well be motivated by legitimate economic rationale rather than enhancing market power (which may be an incidental result).

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?

No, it should not. Potential purchasers should not need to consider whether the OFT will refer a merger which would otherwise fall within the de minimis exception due to its "precedent value".

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?

No.

<i>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?</i>
No. Once the OFT has indicated that it will apply the de minimis exception, the notifying party should be able to waive its right to an issues letter. This would be consistent with the objectives of the de minimis regime, i.e. in order to reduce the public costs of a phase one investigation.
<i>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?</i>
Yes.
Questions about arrangements insufficiently far advanced/insufficiently likely to proceed
<i>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?</i>
No.
Questions about customer benefits
<i>Q13 Is the OFT applying the correct evidential standard in relation to customer benefits?</i>
Yes.
<i>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?</i>
Yes.
<i>Q15 Is it right to consider evidence on customer benefits on a sliding scale?</i>
Yes, this is the most appropriate means of assessing customer benefits.
<i>Q16 Why have parties been unable to substantiate a customer benefits exception at phase one under the Act to date?</i>
Clearly no appropriate circumstances have arisen. Notwithstanding the fact that the OFT has not applied this exception to date, we consider it should continue to be considered.

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 OFT's pragmatic approach in *Co-operative Group Limited/Somerfield Limited* established that a mitigatory remedy may be appropriate in narrow circumstances. Paragraph 5.16 adequately addresses the OFT's approach.

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?

As a result of the established reference test, there is an unavoidable risk of over-enforcement, i.e. because the standard that the OFT is required to apply is lower than that applied by the CC. The proportion of UIL cases compared with the total number of merger cases reviewed by the OFT is relatively small. However, the fact that just over half of all mergers referred to the CC since the Enterprise Act came into force have been cleared without requiring divestments or behavioural undertakings demonstrates that the OFT has referred a number of decisions which were found not to have created an SLC following detailed investigation. It is also plausible that a proportion of the mergers abandoned by parties on reference to the CC might have been cleared by the CC if the parties had not taken the decision to abandon the merger due to the costs associated and/or the length of a CC investigation.

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

Yes. Where the OFT seeks to refer a completed merger and is unwilling to accept any structural or behavioural undertakings from the parties concerned it would be more cost effective in terms of reduced costs to the public purse (to fund a CC investigation) and for the parties involved.

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

To some degree. Proportionality is less relevant at the OFT stage of investigation (as opposed to the CC stage) because the parties involved must take the initiative and decide what undertakings they are prepared to give in order to address the competition concerns. However, this decision is, in practice, informed by guidance provided by the OFT during its investigation.

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

We consider that the issue here is not related to the OFT's powers but rather the fact that if the divestment raised substantive competition issues the proposed purchaser would not be approved by the OFT. However, as noted in the Draft Guidance, it is still possible that the divestment could create a relevant merger situation.

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

Assuming that the OFT approves a proposed purchaser, we consider there to be few foreseeable circumstances where it would be appropriate for the OFT to seek informal ongoing behavioural commitments from a purchaser. We consider this might be appropriate where it is clear that a divestment will address the adverse competition issues but there are limited potential buyers interested in acquiring the business or assets. The OFT might require behavioural commitments if the OFT is specifically concerned that a purchaser might act in a way which will defeat the objectives of the original divestment.

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?

Whilst the majority of purchasers would prefer to give an upfront buyer UIL (rather than having a merger referred to the CC) the OFT must acknowledge that this is likely to place a significant burden on the purchaser. Particularly in light of the current economic climate, requiring a purchaser to find an upfront buyer in a relatively short period of time may lead to mergers being referred purely because there are few if any purchasers (with the necessary financial backing) willing to agree a sale in a short period. We note that the OFT's Mergers – Jurisdictional and Procedural Guidance (June 2009) provides that "*this time period is likely to be a matter of weeks, rather than months, but will depend on the circumstances.*" In practice, we note that the OFT has shown flexibility and willingness to allow parties a reasonable period (of several months in some cases) unless there were circumstances which justify a reference being made, i.e. where the parties have not been willing to co-operate fully with the OFT.