

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

Simmons & Simmons welcomes the opportunity to comment on the *Mergers – Exceptions to the duty to refer and undertakings in lieu* draft guidance consultation document (the “Consultation Draft”) prepared by the Office of Fair Trading (OFT).

### **General comments**

In general terms, we consider that the Consultation Draft is useful to legal advisers and their clients. We found the guidance offered to be clear and helpful as a statement of how the OFT would approach the application of both the statutory exceptions to its duty to refer and undertakings in lieu of a reference.

We provide below some comments on and suggestions for amendment of the Consultation Draft. The relatively limited number of these comments should be seen as a reflection of the fact that we found the Draft Consultation to be generally useful.

We have also provided brief responses to the specific questions posed by the OFT at the end of each chapter (and summarised in Annex A) of the Consultation Draft. These responses have been set out in Annex 1 to this letter. Where a comment in the body of the letter is relevant to the response to one of these questions, we have inserted an appropriate cross-reference.

The OFT has correctly identified that it is important for external stakeholders to have predictability. In order to achieve this, our principal concern is to ensure that the Consultation Draft provides as much guidance as possible in relation to the areas it covers, in terms of the clearest statement of the OFT’s approach and the factors which it takes into consideration both when applying the exceptions to the duty to refer and deciding to accept undertakings in lieu. We recognise that the exceptions to the duty to refer are all areas where the OFT must exercise its discretion and that the exercise of a discretion involves an inevitable element of uncertainty and, therefore, a lack of predictability. We also recognise that the application of undertakings in lieu is complex and, although it is the parties which offer them, it is for the OFT to decide whether such undertakings in lieu satisfy the clear-cut standard. Consequently, it is very important to us and to our clients to ensure that the OFT is as transparent as it can be about the process which it follows and the factors it takes into account in deciding not to refer a merger to the Competition Commission on the basis of one of the grounds covered in the Consultation Draft. We consider that there are some parts of the Draft Consultation where further guidance could be usefully included; and we have sought to identify these areas in our specific comments below. In our view, stakeholders would benefit from further guidance more generally on the procedure and we would, therefore, encourage the OFT to give further thought to where this could be offered in the Consultation Draft.

### **Specific comments and suggestions for amendment**

We set out below some specific comments and suggestions for amendment in relation to a number of areas of the Draft Consultation. We deal with these in the order in which they appear in the Draft Consultation document, not in any order of priority. References to paragraph numbers, footnotes and defined terms are references to paragraph numbers, footnotes and defined terms in the Draft Consultation.

#### *Paragraph 2.14*

We recognise that the OFT is seeking to be helpful when it indicates that it would “*expect the de minimis exception generally to apply where the size of the affected market(s) is below £3m*”. The

OFT goes on to stress that there may be a “particular factual matrix” in markets of this size which will nevertheless cause the exception not to be applied. It is not clear to us whether this particular factual matrix is something different from the factual situation which might cause the *de minimis* exception not to apply in a market the total value of which exceeds £3m. In addition to the size of the total market, the OFT identifies three other key variables as indicators that consumer harm potentially resulting from the merger is likely to exceed the cost of a reference: namely, the strength of the OFT’s concern that harm will occur, the magnitude of competition lost and the durability of the merger’s impact; as well as the matter of deterrence. Is the “particular factual matrix” referred to in paragraph 2.14 simply where all of the remaining three key variables and the deterrence factor all point away from the exercise of the discretion or would it be something more than this? Or could it be something less? If the OFT’s assessment is different where the total size of the affected market is below £3m, we would welcome further guidance on how it differs.

*Paragraphs 2.22 to 2.27*

We understand that the OFT should take a conservative approach to assessing whether undertakings in lieu are “in principle” available. We consider that the question whether a given set of undertakings in lieu satisfies the “clear-cut” standard, on the one hand, and the OFT’s judgment as to whether undertakings in lieu are “in principle” available, on the other, are different issues. In all cases where the OFT is able to identify “in principle” undertakings in lieu these would need to be clear-cut; however, it may be possible to identify clear-cut undertakings in lieu which would not satisfy the “in principle” assessment. We wonder whether this distinction should be made clearer in this section.

*Paragraph 2.38*

Whilst we acknowledge that, in some circumstances, evidence of previous co-ordination in the market may indicate the possibility of co-ordinated effects being a concern, we would caution against an approach that, as a matter of course, assumes that a previous instance of a horizontal infringement in the market is a likely marker for increased co-ordination post merger. We think it at least as likely that a proven breach of co-ordination in a market will act as a deterrent. We would, therefore, recommend that the importance of this element is not overstated.

*Paragraph 2.39*

We agree in principle that vulnerable consumers should merit particular protection, provided this is possible within the legal framework established under the Act. However, it is not clear to us – and we would value guidance on – what exactly is meant by “vulnerable” consumer. Are there defined categories of consumers which are vulnerable and, if so, what are they? If not, we are concerned that vulnerability could be seen as a relative concept and so introduce a further (and unwelcome) element of uncertainty. For example, would end-customers be seen as more vulnerable than business customers and so worthy of enhanced protection?

*Paragraph 2.41*

We accept that durability of the merger’s impact is one of the variables which the OFT considers in determining the overall effect of the merger and we consider that this is one of the areas where the parties can usefully submit evidence. In particular, we recognise that this variable may be affected by the level of any barriers to entry into the relevant affected market(s). We consider, however, that this is an area where there is particularly wide scope for the OFT to exercise a significant degree of discretion. Accordingly, we would welcome further guidance, including as to what types of evidence would be likely to convince the OFT that new entry will ultimately occur within a sufficiently short time frame and/or that any impact that the merger has will be limited.

We agree that the need to deter obviously harmful mergers even in small markets is an important factor in the OFT's consideration of whether or not the *de minimis* exception should apply in a particular case, although in our view this is just one of the factors that the OFT must consider, as per paragraph 2.16 of the Draft Guidance.

We have some reservations as to the proposition (in paragraph 2.48) that "*the OFT's action in that first case would cumulatively lead to aggregate consumer harm far in excess of the costs of referring the problematic merger at hand*". It is not, in our view, appropriate to aggregate consumer harm in different *de minimis* cases. Even if this approach were taken, the OFT cannot speculate as to future mergers and then compare any aggregated harm that it envisages to the cost of just one (the first) possible reference. Rather, potential aggregated consumer harm would need to be compared to the cumulative costs of the references of all those (speculative) mergers. Given that it is accepted that there should be a *de minimis* regime in UK merger control, the OFT cannot aggregate the substantial lessening of competition from each potential *de minimis* merger and then conclude that the cumulative consumer harm is too significant to meet the *de minimis* criteria.

A similar point arises in paragraph 2.51. We would argue that, if the potential consolidation described in the first sentence were to occur within the same relevant market, the OFT should deal with each merger as it happens chronologically. It is clearly preferable for the OFT to consider cases as and when they occur, rather than taking a pre-emptively deterrent position based on speculative future consolidation. Given that the transactions that have already taken place would impact on the factors which the OFT assesses in deciding whether or not the *de minimis* criteria are satisfied, it could decide at any point that it was not appropriate to exercise its discretion and refer the merger to the Competition Commission. We suspect that the OFT's concern outlined in this paragraph would only be relevant in relation to a number of similar mergers that could be replicated across different geographic markets. If so, this should be made clearer. Even in that case, our preference would be that different mergers occurring in different geographic markets be dealt with separately and on their merits. Further guidance generally on what situations the OFT is envisioning and how it would propose to tackle them would be helpful.

#### Paragraphs 2.52-2.68

As a preliminary comment, we would stress that we welcome the pragmatic approach taken by the OFT in its suggestions in this section.

In paragraph 2.56, the Draft Consultation provides that, in certain cases, it may be very clear to the OFT that the market is too small in monetary terms to justify a reference. At paragraph 2.58, the Draft Consultation makes it clear that this would be "*regardless of the magnitude, likelihood or duration of any substantial lessening of competition, and taking into account any potential deterrent effects that could arise from the reference*". This seems to suggest that there is a total market size below which the OFT considers that it will never be justified in making a reference.

Similarly at paragraph 2.66, the Draft Consultation provides that the OFT is likely to be able to move swiftly towards a decision to apply the *de minimis* exception in cases where it becomes clear to the OFT during its investigation that the affected market(s) is (or are) of insufficient importance to justify a reference. Again, the Draft Consultation makes it clear that this is regardless of the magnitude, likelihood or duration of any lessening of competition (although we note there is no mention of any potential deterrence effects here). As above, this appears to suggest that there may be a minimum total market value, below which a reference will never be justified.

It would be helpful, therefore, to know what factors would enable the OFT clearly to identify that an affected market is of "*insufficient importance*" so that the parties are aware of the evidence that

they should present. It would also be helpful to understand which factors would militate against that positive outcome. Further guidance would be welcome.

*Paragraph 4.14*

We consider that the Draft Consultation should make it clear that the customer benefits can also accrue to future customers. Any guidance on what this may mean in practice in terms of the evidence which could be provided to the OFT would also be useful.

*Paragraph 5.31*

We accept that if the OFT were required to carry out a detailed investigation in order to approve a purchaser this would not satisfy the clear-cut standard required by the OFT. We also note that the OFT will carry out a proportionate amount of analysis and investigation in making its assessment of whether a purchaser fulfils the clear-cut standard requirements. We recognise that this position is in line with that confirmed by the Competition Appeal Tribunal in *Co-operative Group (CWS) Limited v OFT*. However, it would be helpful if the OFT could provide some guidance on where the line between an (acceptable) proportionate amount of analysis and investigation and an (unacceptable) detailed investigation should be drawn.

## Annex 1

## RESPONSES TO SPECIFIC OFT QUESTIONS

1. **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?**

We agree that a cost/benefit approach is a reasonable basis on which to assess whether or not to exercise the “de minimis” discretion. Such an approach, however, involves inherent uncertainties and so is likely to prove difficult to interpret for companies and their advisers seeking to interpret it. Accordingly, it is particularly important that the OFT provides as much guidance wherever it can on how it will exercise this discretion.

2. **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 consider that it would be appropriate – and more representative - to take some account of the level of private costs in considering the cost of a reference.

3. **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?**

We consider that this approach may result in some inequality between how parties are treated: a transaction for which no “in principle” undertaking in lieu is available could benefit from the *de minimis* criteria; whereas a transaction which satisfied the *de minimis* criteria but for which “in principle” undertakings in lieu can be identified would nevertheless be referred to the Competition Commission. The potential substantial lessening of competition (and its adverse effects) in each case may be of the same magnitude, but the consequences for the respective parties are very different. We recognise the deterrence justification behind the policy adopted by the OFT in Dunfermline Press, however.

4. **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 consider that it is conceptually clear what the OFT intends when it refers to undertakings in lieu being “in principle” available. We consider that it will be possible in most cases to decide whether this “in principle” test is satisfied or not. However, we also consider that there will be a category of borderline cases where this will be less clear. We consider that the category of undertakings in lieu which would satisfy the “in principle” standard should be construed narrowly by the OFT. We refer to our further comments relating to paragraphs 2.22-2.27 in the main text of this response.

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

We consider that deterrence is one of the factors which it is appropriate for the OFT to take into account when considering whether to exercise its discretion not to refer a transaction on the grounds of the *de minimis* exception.

6. **Is it reasonable for the OFT, in considering whether to apply a ‘deterrence multiplier’, to have regard to the economic rationale behind a merger?**

We consider that the economic rationale behind a merger may be relevant to the OFT's decision whether or not to apply a "deterrence multiplier". However, this should be viewed together with all the other factors which it is appropriate for the OFT to be taking into account.

7. **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?**

Although we consider that there may be some merit in retaining this caveat, given its implications for greater uncertainty for potential merging parties, it would need to be construed extremely narrowly (and this should be made clear in any guidance).

8. **Do you agree with the OFT's stated intention to use 'de minimis' to reduce, where possible, the costs of a phase one investigation?**

We agree that, where it is possible to reduce the costs (and time) of a Phase I investigation by using the *de minimis* criteria, this should be done. We welcome the OFT's pragmatic suggestions in this regard. Please note our comments relating to paragraphs 2.52-2.68 in the main text of this letter.

9. **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?**

We have no comment on this.

10. **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 have no comment on this.

11. **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 have indicated that further guidance would be welcome in a number of places in the main text of the response.

12. **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 types of situation where the OFT has not employed the exception to the duty to refer based on arrangements being insufficiently far advanced or insufficiently likely to proceed, but where it should have done so and should do so going forward.

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

We have no specific comment on this, although we refer the OFT to our response to Question 16 below.

14. **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?**

We have no comments on the OFT's explanation of this relationship.

15. **Is it right to consider evidence on customer benefits on a sliding scale?**

We consider that this is an appropriate approach to considering evidence on customer benefits.

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

We consider that there may be a number of reasons for this. Firstly, we suspect that parties seeking to bring efficiencies arguments (to avoid a finding of a substantial lessening of competition) and customer benefits arguments (to seek to avoid a reference once a substantial lessening of competition has been identified) may not always distinguish assiduously between the two when putting forward evidence. Conceptually, these two arguments share many common elements and much of the evidence to support each argument will be similar (or the same). More compelling evidence will be needed to support a successful customer benefits argument than a successful efficiencies argument. This is because, in the case of a customer benefits argument, a substantial lessening of competition has actually been identified and will need to be countered; and also because, whereas an efficiencies argument involves comparing apples with apples (for example, a pre-merger price with a post-merger price), a customer benefits argument may involve a comparison of apples with pears (for example, a post-merger increase in prices against a commensurate increase in quality). If the parties fail to persuade the OFT that there are efficiencies which negate the existence of a substantial lessening of competition, the OFT may be unwilling to accept that in relation to the same merger there are then customer benefits which outweigh the substantial lessening of competition once identified. This is particularly understandable if the evidence being brought is similar or the same. Conversely, if the parties succeed in convincing the OFT that there are efficiencies which prevent the finding of a substantial lessening of competition, then there will be no need to test customer benefits arguments.

17. **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 do consider that there will be circumstances where it is clear already at the OFT phase that the Competition Commission "*would be to no material extent better placed than the OFT to achieve a remedy that would restore the levels of competition that existed pre-merger*". In these cases, the OFT should be willing to accept a mitigatory remedy rather than referring the transaction to the Competition Commission.

18. **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?**

It is for the parties to offer what they consider to be appropriate. They presumably will not offer an undertaking in lieu if they consider that it constitutes over-enforcement and, rather, would choose to argue their case afresh in front of the Competition Commission.

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

We consider that the OFT should be prepared to allow parties to abandon/totally unwind a transaction through undertakings in lieu, if the parties decide that it is in their best interests to do so. However, we agree with paragraph 2.26 of the Draft Consultation that such an undertaking in lieu should not satisfy the “in principle” standard in relation to the *de minimis* exception.

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

We agree that it is difficult to take account of this at the OFT stage.

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

We do agree.

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

We are not aware of any circumstances where the OFT should seek such informal ongoing behavioural commitments from a purchaser of divestment assets or a divestment business.

23. **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?**

We consider that the use of the upfront buyer mechanism is extremely onerous on the parties and that it should only be used in very exceptional circumstances.