

COMPETITION COMMISSION/OFFICE OF FAIR TRADING

JOINT MERGER ASSESSMENT GUIDELINES SEMINAR

held at

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Cliffords Inn, Fetter Lane, London EC4A 1LD
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PANELLISTS

Chairman

Mr Peter Freeman (Chairman, CC)

Panel

Ms Amelia Fletcher (Chief Economist and Senior Director of Mergers, OFT)

Mr Chris Bowden (Legal Adviser, CC)

Mr Robin Finer (Director of Economic Analysis, CC)

Ms Morven Hadden (Legal Director, CC)

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1 INTRODUCTION

2
3 CHAIRMAN: Ladies and gentleman—and Lord Blackwell if he is
4 here—good afternoon and welcome to the Competition
5 Commission on the occasion of this joint OFT/CC
6 consultation meeting. This is part of our consultation on
7 the airing of the draft merger assessment guidelines.

8 One thing I have not been able to do in this place is
9 make all the clocks tell the same time. I believe it is
10 2.10 by *that* clock, not by *those* two, but do not worry.
11 People wonder why we cannot make all the clocks work.

12 I am sorry if some of you received misallocated
13 badges; that is to say, you were given the right names but
14 some were allocated to institutions that they had either
15 left or had no intention ever of joining. It does not
16 apply to all of you, but it is a case where you cannot
17 even rely on the unreliability of the labels. That is out
18 of our hands. We live in a rented building and the
19 security is managed by others.

20 Why are we doing this exercise? We are doing it
21 really for three reasons: first, to take account of and
22 try to share the lessons that both the OFT and CC have
23 learnt from five or six years of application of the
24 previous guidelines under the Enterprise Act in different

1 ways; second, simply to contribute to transparency and
2 understanding; and, third, I suppose it is to help reduce
3 the burden on business. That is the great cry these days.

4 To deal with those matters in reverse order, as to
5 lifting the burden and increasing transparency we receive
6 criticisms, not many, of the merger regime in this
7 country, not so much that it delivers the wrong decisions
8 but that it is heavy, intrusive and time-consuming. The
9 draft guidelines give us the opportunity to implement some
10 process improvements and make the analysis clearer so we
11 can improve that. Our job jointly is to make the UK system
12 work efficiently and effectively. All competition
13 authorities face the task of getting right the balance
14 between phase one and phase two. We have already made some
15 progress there. The wider availability of undertakings in
16 lieu and greater use by the OFT of *de minimis* have already
17 brought about some improvements and there may be further
18 scope for the introduction of more fast tracking of
19 mergers that clearly should go to phase two, not hanging
20 around at phase one unnecessarily. I hope that these
21 guidelines will help to bring that about. The objective is
22 to make sure the work is correctly allocated so that the
23 right cases are dealt with with the right emphasis by the
24 right authority in the right way. We can debate all

1 afternoon whether we could have a better system, but that
2 is not the purpose of this consultation which is to
3 contribute towards making the present system work
4 effectively.

5 In terms of lessons learnt, what you read in the
6 draft document shows how our assessment has evolved. We
7 are not talking here about radical change but about
8 evolution and taking account of it so that what we publish
9 and rely on is genuinely up to date. I shall not say any
10 more about how we have evolved; others will talk about
11 that this afternoon, but the function of it is to take
12 account of that evolution.

13 I suppose that another area where the guidelines may
14 be helpful is the definition of a merger. It may be
15 absolutely obvious but it is necessary to be clear about
16 to what situations the system is being applied. We thought
17 we had got it clear but there is some litigation still
18 under way as to what material influence may comprise in a
19 particular case. I would like to feel we were all agreed
20 at least on the principles we are applying and that the
21 disputes that are going on are about how they are applied.
22 In that respect the consultation document you have is
23 necessarily incomplete because we do not second guess what
24 the Court of Appeal may say.

1 The other area where there is some interesting
2 material in the document is public interest. When we were
3 writing commentaries on the Enterprise Act nobody paid
4 much attention to the public interest; it was always the
5 bit at the back. People said that there were also the
6 public interest arrangements. For a number of reasons the
7 public interest aspects of merger control have come to the
8 fore recently not only as a result of hard times in the
9 banking world but also in the area of media mergers where
10 they are obviously very significant and the interplay
11 between the authorities and the secretary of state and the
12 criteria applied are obviously very important. Again,
13 there is litigation going on so we do not have the last
14 word on that.

15 There is also the issue of financial stability. We
16 have had a demonstration that the list of public interest
17 criteria is not closed and can be amended even during the
18 passage of a particular case. That was never in doubt but
19 it is interesting to see how it works. We shall not waste
20 too much time wringing our hands over Lloyds and HBOS, if
21 anybody is so inclined. As I have said several times, I
22 regard that as an example of the system working as opposed
23 to not working.

1 We have a galaxy of talent here and my job is to hold
2 the ring. I want to finish on time, which is 4.30 by the
3 clock over *there*. We shall try to provide as much
4 opportunity for discussion as possible while also trying
5 to structure the presentations around the various topics
6 that have been identified. A record is being made. The
7 stenographer *there* is by far the most important person in
8 the room and if you cannot make your mark with her you may
9 as well not be here. Therefore, when we get to the
10 discussion—there will be a roving microphone—please
11 identify yourselves. That is very important for the
12 written record. We will try to do the same.

13 I am sure that I should be reading fire instructions.
14 Basically, if the fire alarm goes off proceed slowly in
15 *that* direction and gather in Bloomsbury Square.

16 This seminar is part of a wider consultation
17 exercise; it is open government. We are delighted to have
18 you here. I think the next person to take us forward is
19 Amelia Fletcher.

20
21 **OVERVIEW OF CHANGES IN SLC METHODOLOGY**

22
23 MS FLETCHER: If Peter is the compère for today's entertainment
24 then I am the warm-up act for the talent that comes later.

1 I shall be very brief by giving an introductory overview
2 of some of the main changes that we think we have made in
3 the guidelines to the SLC methodology employed when
4 carrying out merger assessment, but there are plenty of
5 other little nuances and changes that will emerge in the
6 ensuing talks.

7 Essentially, I want to highlight four main areas of
8 change since 2003 where we think development has occurred
9 in the light of experience of cases, both our own and
10 those more widely particularly in Europe, and also as a
11 result of growing economic understanding of the things we
12 are looking at and how we can apply the economics to the
13 policy.

14 The four main areas I want to highlight where there
15 have been developments are: market definition; co-
16 ordinated effects, where we had a really useful academic
17 round table (in which some of those here were involved) to
18 think about the economics in that area and likewise we
19 also had a round table on the third area, non-horizontal
20 mergers; and, lastly, efficiencies. I shall discuss each
21 in turn briefly, but much more detail will be provided
22 later.

23 As to market definition I think the main thing we
24 seek to do in the guidelines is downplay its role. It

1 remains very important but not as important as is
2 sometimes made out. We are trying to downplay the role of
3 market shares and concentration as well. In turn, in the
4 area of unilateral effects we seek to raise the profile of
5 the actual analysis of the competitive constraints that
6 the merging parties place upon each other, which would be
7 lost as a result of the merger.

8 What is not on this slide, though I suspect it will
9 result in later discussion, is what we have said in the
10 guidelines about the probative nature, when looking at the
11 unilateral effects, of the combination of high diversion
12 ratios and profit margins. This is another change in the
13 guidelines.

14 Another change that may result in discussion is the
15 emphasis we have placed on changing the role of supply
16 side substitution. We have also emphasised some of the
17 complications in market definition, for example around
18 multi-sided markets.

19 As to co-ordinated effects we have broadly followed
20 what is becoming established practice in using three
21 conditions: first, that the parties can reach and monitor
22 co-ordination. We can think of that as the 'ability'
23 condition. The second one is that there is internal
24 stability of the co-ordination. You can think of that as

1 the incentive condition. Do the parties have the incentive
2 to maintain this co-ordination? The third condition is the
3 external stability condition. Whatever the parties do, can
4 they make this co-ordination work? Can it have an effect?
5 Therefore, that is the 'effect' condition. It is quite
6 interesting that you can look at these three conditions as
7 ability, incentive and effect in the same way we are now
8 seeking to do in the non-horizontal part of the guidelines
9 to which I will come in due course.

10 There are two cross-cutting factors we have
11 highlighted as affecting all three of these elements. The
12 first is evidence of pre-existing co-ordination. There are
13 some interesting questions to be asked around that point.
14 What kind of evidence of pre-existing co-ordination do we
15 need and in what circumstances might we actually draw on
16 that? The second factor is the role of concentration and
17 symmetry both of which potentially affect all three of
18 those steps. We think that our approach, which is
19 essentially that there must be a story of why the merger
20 would enhance the likelihood of co-ordination, is broadly
21 consistent with recent EC co-ordinated effects cases post-
22 Impala such as ABF/GBI (Yeast).

23 As to non-horizontal mergers, we very clearly
24 recognise in the guidelines that most of these will be

1 benign at worst and probably beneficial because there is
2 not a reduction in competition between competitors and
3 because efficiencies can be garnered from the combination
4 of a supplier and downstream firm. As we discovered
5 earlier, the badges might well have come out right had the
6 CC done it themselves rather than delegated it downstream.
7 Maybe a vertical merger would have been good!

8 However, what we do talk about in the guidelines is
9 diagonal mergers which arise where a supplier, rather than
10 merging with its own distributor, merges with its
11 competitors' distributor or another player's distributor.
12 In that circumstance the anti-competitive effects tend to
13 be greater, the efficiency benefits would tend to be
14 smaller, and one might think it would be more likely to
15 raise the sorts of concerns that one sees in horizontal
16 mergers. In reality, there is likely to be a spectrum of
17 vertical mergers, with many having elements of the pure
18 vertical, which tend to be benign, and of the diagonal,
19 which tend to be more problematic. Obviously mergers along
20 this spectrum are particularly difficult to analyse. In
21 analysing them we broadly follow DG Comp's guidance which
22 is obviously a lot longer and more detailed than ours. The
23 overarching framework is to look at the ability, incentive

1 and likely effect of the merging parties to engage in
2 either full or partial foreclosure.

3 I am a great fan of Venn diagrams and this one
4 attempts to illustrate the interrelated nature of each of
5 these elements. 'Ability' is primarily about market power;
6 'incentive' is around whether the foreclosure, full or
7 partial, will be profit-enhancing; and the main point to
8 highlight on 'effect' is that we are not necessarily
9 concerned about the impact on competitors but on
10 competition. That is where 'efficiencies' comes into play
11 because sometimes efficiencies resulting from the merger
12 mean that competition may be stronger even though some
13 competitors are potentially harmed.

14 One other thing that may generate discussion is that
15 we have made an explicit distinction between the OFT and
16 the CC treatment of non-horizontal mergers. We have said
17 that if the OFT finds there is a realistic likelihood of
18 incentive and ability then we do not need to go on to look
19 at effect; we can just presume effect, unless there are
20 very good arguments to the contrary. The CC will do a full
21 incentive-ability-effect analysis.

22 Finally, on efficiencies obviously we shall keep the
23 two gateways that legislation gives us but what we have
24 endeavoured to do in the guidelines is try to clarify the

1 distinction between those efficiencies that prevent an SLC
2 from occurring at all and those customer benefits which
3 can countervail the negative effects of an SLC, which
4 means that even though there is an SLC we think the merger
5 should be allowed to proceed.

6 We have also dropped the terminology of rivalry-
7 enhancing efficiencies. We felt that the term 'rivalry-
8 enhancing' came to mean one particular situation, namely
9 where two small players merge and thereby can compete more
10 effectively against one bigger competitor. We thought that
11 whilst that was a perfectly good story it was only a
12 subset of the potential efficiency arguments that we might
13 want to accept in a merger. It is possible that the term
14 'rivalry-enhancing' drawn more widely could cover
15 everything we wanted it to but we thought it was easier
16 just to drop the term.

17 We have gone through a number of different
18 efficiencies that we would be interested in looking at. We
19 have also categorised them into demand side and supply
20 side efficiencies. I think this is useful but it may also
21 generate discussion.

22 That is all from me. The first main act on today is
23 nothing to do with any of the things I have mentioned. For
24 some in the room it is probably more interesting than any

1 of the more 'economic' stuff. I notice that today the
2 lawyers and economists have been separated. This does not
3 at all reflect the way in which we have worked on these
4 guidelines. It has been an incredibly tightly-knit effort
5 by lawyers and economists and others across the OFT and
6 the CC, so I hope that will prove itself today.

7 CHAIRMAN: We thought that distinction was better than having
8 OFT on one side and the CC on the other. We do not propose
9 to take questions now; that is a genuine warm-up act.
10 Therefore, we shall move straight on to the next topic
11 which is a double act that will generate discussion.

12
13 **THE COUNTERFACTUAL**

14
15 MS HADDEN: As lawyers, both Nick and I perhaps feel we are
16 slight frauds sitting here discussing a concept that does
17 not appear anywhere in the legislation. However, the
18 counterfactual is an important part of the framework for
19 assessing whether a merger gives rise to an SLC. The
20 concept is one that I am sure is known to everyone in the
21 room. Establishing whether or not a merger gives rise to
22 an SLC involves a comparison of the prospects for
23 competition with the merger against the competitive
24 situation without it, the latter being the counterfactual.

1 Generally, both the OFT and CC will assess the
2 counterfactual over the foreseeable future in the same way
3 that the effects of the merger are analysed. That is not
4 always straightforward. There may be cases where the
5 foreseeable future turns out to be quite a short period in
6 practice. However, one important matter to bear in mind is
7 that the developments that would have arisen, or might be
8 expected to arise, as a result of the merger do not form
9 part of the counterfactual; that is part of the
10 competitive assessment. It is not always easy to determine
11 on which side of the line developments will fall; in
12 particular, if there are market developments that may be
13 accelerated in some way as a result of the merger.

14 We shall conduct a brief canter through it and if
15 there are any questions we shall be very happy to defer
16 them, probably to our economist colleagues! We will do our
17 best to take you through the cases that we have been
18 looking at in developing the guidelines. We want to look
19 generally at the differences in approach as between the
20 OFT and CC. There are acknowledged differences. That is
21 entirely appropriate because we are different authorities
22 with different statutory roles and obligations. We must
23 answer different questions to a different standard and
24 that is reflected in our treatment of some of these

1 issues. Within that we shall be looking at two primary
2 areas: the failing firm and how we approach multiple bids
3 and parallel transactions.

4 MR SCOLA: Just kicking off with the general approach to the
5 counterfactual that the OFT adopts, obviously our
6 reference test is that we have a duty to refer whenever
7 there is a realistic prospect of an SLC and that must take
8 account of the fact that there are a number of different
9 possible counterfactuals against which the merger should
10 be judged. As a first phase agency we do not have the time
11 and luxury to delve into what that actually would be on a
12 balance of probabilities assessment, but when we look at
13 the merger we need to take account of the fact that there
14 is a degree of uncertainty as to what would have happened
15 absent that merger.

16 The way we attempt to reconcile this tension
17 effectively is by adopting a working presumption that the
18 prevailing conditions of competition at the time of the
19 merger are those against which the merger should be
20 judged. I think that would generally equate to what you
21 might call a relatively cautious approach to merger
22 assessment which is appropriate given the level of the
23 statutory test. But that is very much a working
24 presumption and clearly can be rebutted in the presence of

1 appropriate evidence. The type of evidence that is
2 pertinent might be the exit of one of the two firms in
3 question which is something we frequently encounter in
4 argument and will come on to consider. Obviously, one
5 piece of evidence from the parties is a failing firm-style
6 defence and an exiting firm defence.

7 The other way in which the presumption of prevailing
8 conditions of competition can be rebutted is if we
9 ourselves have information to suggest that one of the two
10 parties at the time of the merger would have gone on to do
11 something more competitive in the market, for example
12 would have entered a new market in which it was not
13 engaged at the time of the merger. Typically, that is
14 evaluated in the form of a potential competition story.

15 MS HADDEN: By contrast with the OFT generally the CC does not
16 operate on the basis of presumptions. We are required to
17 answer the statutory questions on the basis of an
18 expectation—what we think is more likely than not to
19 occur—or the civil standard of the balance of
20 probabilities. That also accords with our approach in
21 relation to the counterfactual. We will consider what is
22 the most likely outcome in the market under investigation
23 and look at the counterfactual on that basis. This often
24 involves looking at the prevailing conditions of

1 competition but that is not always the case. We will
2 consider whether changes in the market are likely absent
3 the merger and how we should approach those. It is not
4 always straightforward. Sometimes those changes in the
5 market are things that would have happened even if the
6 merger had not taken place but they are happening a little
7 more quickly because it has taken place. That can
8 complicate the counterfactual analysis, and it was an
9 issue with which we had to grapple recently in the
10 BOC/Ineos inquiry, but generally speaking the main
11 difference in the approach of the two authorities is that
12 we are required to satisfy ourselves on the basis of an
13 expectation and for that reason we will not rely on
14 rebuttal presumptions.

15 MR SCOLA: In terms of specifics I want to look at a failing
16 firm or exiting firm argument in order to prevent an SLC
17 which is covered in the guidance. I do not think there has
18 been a seismic shift from the previous guidelines issued
19 by the OFT and Competition Commission, but obviously this
20 is an area of interest given current conditions, which is
21 why we think it is worth touching on here.

22 Effectively, there are two limbs, sometimes three
23 depending on how you split the various components. The
24 first one, which is uncontroversial, is that one of the

1 businesses in question would inevitably have exited the
2 market and there should be no serious prospect of
3 reorganisation of that business internally. The guidelines
4 say that generally this will not be the sale of a division
5 by an otherwise successful and profitable firm, but in
6 rare circumstances that criterion may still be met in such
7 circumstances, for example where a firm has inevitably
8 committed to disposing of a certain line of business and
9 it is genuinely committed to exiting the market. One
10 example of that scenario is the Homebase/Focus decision by
11 the OFT.

12 To the extent that the firm in question can
13 demonstrate that it would inevitably have exited the
14 market absent the merger the next limb is effectively
15 whether there is a substantially less anti-competitive
16 alternative to an acquisition by the acquirer in question.
17 This really splits into two different parts. First, was
18 there a substantially more competitive buyer for the
19 business as a going concern? Second, if that is not the
20 case, is there a substantially less anti-competitive
21 alternative to the merger in the form of the actual exit
22 of the firm itself? That sounds slightly strange when you
23 consider that failure of the firm might mean there is
24 greater competition, but effectively it is looking at a

1 situation in which the firm has gone into liquidation and
2 is disbanded, but perhaps its assets are used as a way to
3 enable other firms to enter the market even though they
4 are not purchasing the business. Alternatively, it may
5 simply be the case that other firms would fill the market
6 share void left by the exiting firm in question.

7 One interesting point that the guidelines flesh out
8 is that, when considering realistic alternative buyers for
9 the business, we take account only of buyers who are
10 willing to pay above liquidation value. That is perhaps
11 something on which we can touch later.

12 There are differences in approach here between the
13 OFT and the CC reflecting the different substantive tests
14 that we talked about earlier. The phrase fairly well used
15 in OFT decisions is that it requires "compelling evidence"
16 that these limbs are satisfied, not least because these
17 types of arguments are very easy to allege and obviously
18 in some senses can be a get-out-of-jail-free card if the
19 parties are able to substantiate them properly. Therefore,
20 we are very cautious in assessing the way in which we look
21 at these 'exiting firm' cases.

22 As Morven has explained, the Competition Commission
23 assesses the merger on the standard of likelihood.
24 Therefore, to the extent it regards these limbs as being

1 satisfied, namely that the party in question would exit
2 the market but there would have been an alternative
3 purchaser, it is comparing effectively the two mergers one
4 against the other; in other words, does this merger result
5 in an SLC compared with the counterfactual which is a
6 purchase by the other party? This is an interesting
7 difference in the approach of the OFT and CC in looking at
8 this question, which reflects the statutory tests.

9 MS HADDEN: There is one final point to make in relation to the
10 'failing firm' criteria. Although we operate on the basis
11 of an expectation nevertheless we push parties quite hard
12 to establish that those criteria are met. We will look
13 very carefully at the financing of the business and at
14 what alternatives are out there, including whether a
15 business will genuinely be pushed to the point of
16 liquidation or whether the sell off through administration
17 of either the business as a whole or in part is something
18 we consider to be a more likely alternative. That was a
19 matter which came up in the Thermo Electron
20 Manufacturing/GV Instruments case.

21 The other area on which we want to touch this
22 afternoon is competing bids and parallel transactions. In
23 some senses parallel transactions are not necessarily
24 issues relating to counterfactual although they are dealt

1 with within that section of our guidance largely as a
2 matter of convenience. Looking through the guidance, these
3 things should not really come as any great surprise to
4 you. These are not new statements of policy but a
5 reflection of our existing practice and the way it has
6 developed over the time that we have been looking at cases
7 under the Enterprise Act.

8 Considering first competing bids, the OFT approach is
9 primarily to consider the merger as against prevailing
10 conditions of competition which means that the OFT will
11 examine each competing bid separately and whether the
12 particular merger creates a realistic prospect of an SLC
13 as against prevailing conditions of competition. The CC
14 approach is one based on expectation of the most likely
15 outcome, so if only one of the competing bids is referred
16 to the Competition Commission the counterfactual is likely
17 to be the pre-merger competition conditions which may
18 include an assessment of how likely it is that the non-
19 referred bid will proceed. In practice the analysis may
20 not be all that different, but we shall be looking at
21 either pre-merger competition conditions or an expectation
22 that the alternative bid that has not come to us—so by
23 definition it has not been found to give rise to
24 competition concerns—would proceed.

1 The situation is slightly different where two or more
2 bids are referred to the Competition Commission. In that
3 case the counterfactual is unlikely to be any of the bids
4 referred to us because a prima facie competition concern
5 has been identified. Similarly, in general the CC will not
6 consider a remedied bidder as a suitable counterfactual.
7 There is an exception to that in a very distinct set of
8 cases concerning railway franchises. This is set out in a
9 little more detail in the guidance, but in those cases we
10 cannot rely on the pre-merger situation because that will
11 not continue to be the case. It is inevitable that the
12 franchise will be awarded to one of the short-listed
13 bidders. Therefore, in those cases we will consider the
14 counterfactual as an award to a bidder that has not been
15 referred to us, if any of them have not been referred, or,
16 if all of the bidders raise competition concerns, we will
17 treat the counterfactual as a hypothetical bidder with any
18 competition concerns remedied most likely through
19 behavioural measures.

20 Parallel transactions are a slightly different
21 construct. In considering such transactions the OFT will
22 usually consider whether there is a realistic prospect of
23 competition whether or not the parallel transaction
24 proceeds. By contrast, the CC looking at expectations will

1 consider whether or not it believes that that parallel
2 transaction is likely to proceed and, if so, its
3 counterfactual will take account of that.

4 That is a quick canter through counterfactual. We are
5 happy to take questions, or refer them to colleagues here,
6 in relation to the approach of either authority. There
7 will be an opportunity to take questions later in the
8 course of the proceedings.

9 MR GAVIN ROBERT (Linklaters): In relation to parallel
10 transactions do you apply the same rule that the European
11 Commission applies around first come first served? I was
12 surprised that such discussion was not in the draft
13 guidance.

14 MS HADDEN: That is primarily because we have not been put in a
15 situation where we have had to put that to the test. It
16 has been considered in the context of LSE by the OFT.

17 MR SCOLA: We have looked at it in that context and most
18 recently we have looked at it in a steel manufacturing
19 case (Celsa). Obviously, there would be a conceptual
20 benefit in trying to align our practice with the European
21 Commission to provide certainty and predictability. At
22 least at the OFT stage, however, I do not believe that is
23 something we are doing for the reason that the advice we
24 have received is that when looking at the realistic

1 prospect test, we must take account of the possibility
2 that we may be judging the merger against a number of
3 different outcomes, one of which is whether or not some of
4 the parallel transactions go ahead. For us simply to say
5 that because a particular deal came to our notice first we
6 are ignoring the other deal is to deem too much to have
7 happened (or not to have happened). It also raises quite
8 difficult questions in terms of the voluntary regime and
9 the completed/anticipated dynamic which is not something
10 that the European Commission has because of the way the
11 system works. Therefore, I think the answer is no.
12 Certainly, at the first phase we would not adopt a strict
13 first-past-the-post approach.

14 MS HADDEN: In relation to the CC the key factor is its
15 expectation of what is the likely outcome and the mere
16 timing of the transaction does not necessarily mean that
17 inevitably we would reach the expectation that that
18 transaction would go ahead. Timing might be one of the
19 issues but it is not necessarily the only thing that would
20 be looked at in our analysis.

21 MR ROBERT: I just comment that given the radical impact of a
22 first-past-the-post rule some discussion of it in the
23 guidance—to say that you are not applying it or you might
24 apply it—would be important for the purpose of legal

1 certainty. That is particularly important for the
2 Competition Commission in terms of both parallel
3 transactions. Because of the way Mr Scola suggested they
4 might be looked at by the OFT both parallel transactions
5 might be referred. It would then become of absolutely
6 critical importance in an oligarchical market structure
7 with parallel transactions.

8 CHAIRMAN: We will take that away and look at it. There are a
9 number of ways in which procedurally our regime is not
10 aligned with that of the EU. As you well know, it is not a
11 compulsory notification system.

12 MR SIMON PRITCHARD (Allen & Overy LLP): Nick, does that mean
13 that the paragraph in the OFT's *Mergers-Jurisdictional and*
14 *Procedural Guidance* that essentially talks about the
15 European first-past-the-post rule that has aligned with
16 the EC, which I gather is in the pipeline, is to be
17 removed from the final product?

18 MR SCOLA: That is right. As I mentioned to Gavin Robert, we put
19 out the consultation on the J&P guidance because we looked
20 at the European Commission system and thought there was
21 great merit in having that certainty in terms of
22 predictability, but on further reflection, taking account
23 of the response to the consultation, we do not think it
24 aligns very neatly with the reference test.

1 MR PRITCHARD: The approach on failing divisions sets a slightly
2 hushed tone in the sense that it is characterised as being
3 more likely to be exceptional. I understand the reasons
4 behind that, but based on decisions in practice I think
5 there have been more failing division clearances at phase
6 one than entire failing firms. I was wondering whether
7 there is a conscious shift to set the bar a little higher
8 for a failing division than a failing firm.

9 MR SCOLA: I do not think so. What it reflects is evidential
10 caution which is that you can have a successful business
11 turning up at the door and saying that inevitably it would
12 exit a particular line of business for whatever reason.
13 Some caution is required before you accept that too
14 easily. I take the point about some of the cases to date,
15 although obviously it is a fairly small sample set.
16 Therefore, it is probably fair to revisit the question
17 later. I believe that the caution in the guidelines is
18 more to do with the evidence that we shall be looking for
19 in terms of the inevitability of that exit. If that is a
20 business decision you will be looking at something that by
21 its nature is not too constructed and appears to run deep
22 and true.

23 MS HADDEN: I entirely agree with Nick. That was something we
24 looked at very carefully in the Long Clawson/Millway

1 merger where an otherwise profitable firm overall had a
2 division that we found was failing. We looked carefully at
3 what the incentives were to make sure there was no
4 possibility that turnover was being manipulated in any way
5 as between businesses within the group and it was
6 genuinely the case that this business satisfied the
7 criteria of failing and there was no possibility that
8 restructuring, which is particularly key in the context of
9 a division rather than a firm, would solve the problem.
10 Those cases are the exception rather than the rule, but in
11 any case they will be looked at very carefully in terms of
12 the available evidence.

13 CHAIRMAN: Are there any further questions? If not, we will move
14 on to my favourite subject: market definition. I should
15 say that the guidelines published so far have benefited
16 from consultation from some distinguished academics. We
17 also held two round tables with other distinguished
18 academics. They have been round various government
19 departments and have benefited from comments by DG Comp,
20 so they are not just the work of the OFT and CC. The
21 process is ongoing.

22

1 MARKET DEFINITION

2
3 MR FINER: Amelia mentioned that the main change in the
4 guidelines was to downplay market definitions, so I hope I
5 am suitably low key and downbeat about the whole thing. In
6 any case, we shall not talk about the role of market
7 definition which may be picked up in the discussion of
8 competitive effects; rather, we intend to focus on just
9 the main developments in terms of process within the
10 guidelines. To this end, first Nicola will give a broad
11 overview of how we think the hypothetical monopolist test
12 should be applied and then I shall pick up a few other
13 aspects in slightly more detail.

14 MR MAZZAROTTO: Thinking about the hypothetical monopolist test,
15 I guess *these* are the things that we would flag up by way
16 of overview of how we look at the implementation of this
17 methodology for the purposes of market definition. I would
18 pick up a couple of broad themes. The first is one that
19 ensures consistency with the rest of the competitive
20 assessment; it is not just unilateral effects but co-
21 ordinated effects despite what is written in the slide.
22 The point here is that we want to make sure we can use a
23 methodology not just to address competition that takes
24 place with respect to price but more generally the

1 competition that takes place with respect to other
2 competitive variables. As we have said many times already
3 today, this is one of those examples where it is not
4 really evolution in practice; it is merely clarification
5 or formalisation of existing practice. Cases as far as
6 back as Zeiss/Bio-Rad in 2004 and more recently
7 Boots/Alliance Unichem before the OFT in 2006 have really
8 used the hypothetical monopolist test as a conceptual
9 framework that applies, certainly to the case of
10 Zeiss/Bio-Rad, to research and development but can be
11 applied also to other dimensions such as quality and
12 service which are seen as equally important.

13 The other aspect that we sought to clarify is the
14 treatment of the different constraints from demand and
15 supply side substitution. Amelia mentioned this at the
16 beginning. I am sure that it can be seen to be placing
17 different emphasis on the two. I believe that what drove
18 us at least to begin with to think about a slightly
19 different way of doing things was mainly the fact that we
20 thought this provided a framework that would give us the
21 flexibility we needed to deal with constraints
22 particularly from supply side substitution that could be
23 dependent on things fairly specific to the firm, such as
24 the ability and incentive it might have to switch to the

1 production of a good. That makes that type of constraint
2 fairly different from a demand side constraint where all
3 that is required is just a switch from consumers to a
4 competitive product and there is intrinsic immediacy in
5 the availability of the product to consumers to begin
6 with.

7 Because this is a slightly different approach I
8 thought I would have a go at some things that pop up on
9 the slide. *Here* we follow an example that we use in the
10 current guidance. The starting point is to have some
11 product. The example we use is one involving liquid egg
12 producers which has been encountered in a recent OFT/CC
13 merger. Those products are identified in red; the stars
14 indicate the firms that produce liquid egg. The green ones
15 indicate firms that produce fruit smoothies. You will
16 appreciate instinctively—that is one of the good things
17 about this example—that if you want to get some liquid egg
18 probably fruit smoothies are not an intuitive demand side
19 substitute. It is probably even more intuitive if you
20 start with the fruit smoothie: you would not want some
21 liquid egg in it or instead of it.

22 Starting from this point, we believe that we shall be
23 defining the relevant market by reference to those demand
24 side substitutes. Therefore, we would call it the market

1 for liquid egg. We stress that this does not mean that the
2 constraints from supply side substitution are ignored;
3 rather, they will be considered on their merit. We will
4 not seek to conduct an analysis that is too crude in terms
5 of just looking at the cost and time taken to switch but
6 really we will consider for each individual firm where are
7 the incentives and ability for it to switch. As firms can
8 have different technology these may be quite different.
9 Assuming that those incentives are different for the two
10 groups of firms closest to the liquid egg producers and
11 they would have the incentive and ability to switch to
12 counter a price increase of the type involved in the
13 hypothetical monopolist test then that is the way in which
14 we would identify the set of competitors. That set of
15 competitors would then feed into the construction of a
16 market share and would be used for the assessment of both
17 unilateral and co-ordinated effects.

18 MR FINER: That is the broad application of the hypothetical
19 monopolist test. There are a few other smaller areas in
20 the guidelines that are possibly slightly different from
21 the previous CC guidance and I should like to focus on a
22 couple of those.

23 First, there is a paragraph in the draft guidelines
24 that rather downplays the role of chains of substitution

1 in market definition. We do not think this is any grand
2 revolution but that a properly applied hypothetical
3 monopolist test will take into account the sorts of
4 considerations you would think about when defining a chain
5 of substitution and breaks in that chain. I do not believe
6 that is a big deal but it is a change.

7 Second, we hope that we have made a little clearer
8 our position on the cellophane fallacy in the current
9 guidelines. What we want to emphasise is that our usual
10 starting point will be the prevailing price in defining a
11 market in a merger investigation. However, what we have
12 done is to leave open the possibility that we may need to
13 be aware of the cellophane fallacy where we believe there
14 may be co-ordinated effects in the market. The reason for
15 this is that if we did not take the cellophane fallacy
16 into account there would be a danger of overlooking the
17 potential harm of a merger between already co-ordinating
18 firms because we might think that they were operating in a
19 wider market.

20 If there is a loss of competition moving from a
21 collusive outcome with some potential instability to all
22 of that market now being held within a single merged firm
23 that is something of which we need to be aware.

1 We have also made more explicit our position on
2 asymmetric constraints in the current draft guidelines.
3 Here the idea is that your starting point in the
4 definition for the hypothetical monopolist test matters.
5 For example, in mergers of grocery retailers you may have
6 two small stores merging in a market which also includes
7 large stores. The flip side is that a merger between two
8 large grocery stores may not include small firms within
9 that relevant market.

10 The next point is: multi-sided markets. Amelia
11 referred to recognising complications. For example, one
12 has the situation where newspaper providers target two
13 audiences: readership and advertisers. The relationship
14 between the two is important. The externality of the
15 effect of a change in readership on what you can command
16 in terms of advertising revenue is an important
17 consideration. I believe that the market definition
18 section of the draft guidance recognises this as an issue.
19 It does not present some generalised model of how we will
20 deal with all the complications; it just recognises that
21 it is there and it is something we must think about.

22 Finally, there is a section on secondary product
23 markets. This is basically imported from the existing OFT
24 guidelines on market definition, but it recognises that

1 the interrelationship between primary and secondary
2 products is important when analysing a merger between two
3 such providers. For example, if you have two firms that
4 provide the servicing of a particular type of helicopter
5 the purchasers of that item take into account the
6 servicing when they buy it. That puts you in a position
7 that is different from the situation where they do not do
8 so. Therefore, you have to take into account all these
9 different factors.

10 CHAIRMAN: Are there any questions on market definition?

11 MR ROBIN NOBLE (Oxera): I was very interested to note that you
12 adopted a 5% SSNIP test as opposed to what I believe was a
13 mixed message previously where one guideline referred to
14 5% to 10%. First, why have you focused specifically on one
15 number? Second, why is that number 5% rather than, say,
16 10%?

17 MR FINER: My understanding is that we have not adopted 5%.

18 Everybody is scrabbling for the relevant paragraph.

19 MR MAZZAROTTO: I think that is right. If that is so it must
20 have been a last-minute printing mistake. I hope we have
21 not made it.

22 MR NOBLE: It is paragraph 4.55 on page 25: '. . .the
23 Authorities will normally apply a price increase of 5 per

1 cent whilst assuming that all other prices remain
2 unchanged.'

3 MR MAZZAROTTO: If you continue reading there is the 'however'
4 bit which our lawyers assured us was a very important
5 paragraph. The idea is that we want to give a sense of
6 what the practice is like. In run-of-the-mill cases in a
7 typical scenario 5% has been used as the default, if you
8 will, but I think that the key principle here, as we say
9 at the end of that paragraph, is that we would make a
10 judgment as to what constituted a small but significant
11 price increase and that might well be different depending
12 on the market we are considering.

13 MR NOBLE: It strikes me that there are several readers at Oxera
14 all of whom independently came up with this and said, 'Oh!
15 It's now 5% rather than 5% to 10%.' That would indicate to
16 me that words matter here and that using the nomenclature
17 of 5% to 10% might be quite important, if that is the
18 wiggle room you are intending to use. If you think about
19 the learning from behavioural economics and the way people
20 respond to surveys, it is much easier to ask someone about
21 10% than about 5%, but if what you are really concerned
22 about is a small price change—obviously, 5% is a lot
23 smaller than 10%—it could have a significant bearing on

1 the way people run surveys and this is analysed in
2 practice. That is perhaps something to think about.

3 CHAIRMAN: We will take that away. It was an area where the
4 guidelines as between OFT and CC were different. Are there
5 any more questions? If we have exhausted the audience on
6 market definition no one will be happier than I.
7 Otherwise, I congratulate you on your low-key
8 presentation. Let us move on to the next topic.

9
10 **UNILATERAL EFFECTS**

11
12 MR WALTERS: I note that in an almost unprecedented departure by
13 OFT and CC we are running substantially ahead of schedule.
14 I suppose that that leaves two alternatives: first, that I
15 talk about unilateral effects for half an hour; second,
16 that we finish a bit earlier and leave more time for
17 questions.

18 CHAIRMAN: Or you can go by the accurate clock down the end!

19 MR WALTERS: I will just pick a clock at random and leave more
20 time for questions and then we can go for refreshments a
21 bit early.

22 As Amelia mentioned, the concept of unilateral
23 effects is one that is very well developed in merger
24 analysis. Consequently, in this area there has been little

1 change from what is in the existing guidelines. However,
2 there is a new structure in terms of the way we think
3 about not just unilateral effects but also co-ordinated
4 and non-horizontal effects which stresses theories of
5 harm. Although that structure pervades all analytical
6 areas of the new guidelines its impact is perhaps most
7 clearly seen in the analysis of unilateral effects. The
8 idea is that that new structure is used to categorise
9 existing indicators of unilateral effects. Those
10 indicators exist in one form or another in both sets of
11 guidelines, but the idea is that the structure can tell
12 you for a given kind of merger which indicator is more
13 probative of unilateral effects than another.
14 Consequently, there is less emphasis on market definition
15 in the way the section on unilateral effects is drafted.

16 We think that the unilateral effects of a horizontal
17 merger are the same regardless of whether that merger is
18 framed as one generating high concentration in a narrowly
19 defined market or as one between closer competitors in a
20 more broadly defined market. Consequently, the previous
21 emphasis on having a definitive statement about market
22 definition is not really there in the current draft of the
23 guidelines. We make the point that in certain cases we can
24 back into market definition from the competitive

1 assessment. In cases where you look at the effect of the
2 merger on competition you consider the closeness of
3 competition that is removed. Sometimes you can back into a
4 market definition from that particular approach and the
5 guidelines make that point.

6 The guidelines also make the point that the OFT and
7 CC will be concerned primarily with the unilateral effects
8 on customers of one or both of the merger firms but may
9 also be mindful of the effects on other firms in the
10 market. In particular, I think the authorities will be
11 more mindful of merger effects on the customers of one or
12 both of the merger firms where the merger is between
13 producers of differentiated products. The authorities will
14 be more concerned about what happens to the merged firms'
15 customers but may also be mindful of the ripple-through
16 effects on parts of the market.

17 The more structured framework that I discussed is
18 illustrated here. It is almost like an intellectual flow
19 chart. You begin by considering what parameters of
20 competition and aspects of competition are important and
21 what strategic weapons the firms use to compete with each
22 other. These can be price and short-term non-price
23 factors: quantity, range, service and quality. Medium-term
24 non-price factors would be, for instance, product variety;

1 or there can be longer-term non-price factors such as
2 innovation or capacity expansion.

3 The authorities will look for aspects of competition
4 that are relevant to the merger and in the light of those
5 they will go on to look at the nature of competition over
6 those competitive aspects and parameters. To pick a couple
7 of well-known examples, if we were to find that the merger
8 involved firms where short-run price or quantity-setting
9 behaviour was particularly important we would postulate
10 the nature of competition with the familiar Cournot and
11 Bertrand models which are the work horses of unilateral
12 effects analysis.

13 Having identified the aspects of competition and its
14 nature and worked out which economic models to use, we
15 would then formulate our theories of harm which I rather
16 dramatically put in the star in the middle of slide. No
17 doubt that is some sort of hawkish Freudian slip. On the
18 basis of those theories of harm we would look at what
19 indicators of unilateral effects are relevant. I have
20 given some examples of indicators of unilateral effects.
21 They also exist in both sets of guidelines in one form or
22 another, so they have been brought together in the hope
23 that this structure will help to categorise indicators
24 showing which ones may be more probative of unilateral

1 effects in which type of merger. Reading down from the top
2 we have: market share, firm numbers, fascia counts,
3 closeness of competition in particular as measured by
4 diversion ratios, the number of alternatives that
5 consumers can switch to and the switching costs involved
6 in so doing. Next we have the question whether or not
7 rivals are easily able to react and whether the merger
8 involves a recent entrant or a firm that is in some sense
9 a novel competitor. Those indicators exist but the
10 structure serves to indicate we hope which are more
11 relevant for which kinds of mergers. In the remaining part
12 of the presentation I shall just talk through a few of
13 those in a bit more detail.

14 Our guidelines emphasise that market shares are most
15 informative for mergers in undifferentiated product
16 markets, that is, industrial-type mergers. The guidelines
17 have abolished the CC's 25% threshold. I put 'safe
18 harbour' in inverted commas because, as I am sure you
19 know, it was not actually a safe harbour per se. The
20 presumption was that mergers generating combined market
21 shares of less than 25% would be unlikely to give rise to
22 a presumption of an anti-competitive effect. However,
23 without making that stronger statement in the guidelines
24 based on OFT's previous decisional practice and our

1 analysis of essentially all phase one mergers since the
2 start of 2006 we say that unilateral effects are unlikely
3 below combined market shares of 40%.

4 To move on to firm numbers, we explain how and why we
5 would use fascia counts in particular mergers, for example
6 mergers of retailers in multiple local geographic markets
7 and what kind of intervention threshold we might set. We
8 emphasise that the closeness of direct competitive
9 constraints removed by the merger is most informative for
10 mergers of differentiated products. In some cases market
11 definition can be very complicated and perhaps resources
12 that could be put into market definition are best used for
13 directly assessing the degree of competitive constraint
14 that is removed by the merger.

15 We mention diversion ratios. Some of the text
16 mentions a number of ways in which you can look at
17 diversion ratios which have been used in previous OFT and
18 CC merger inquiries. We go on to outline the role of the
19 combination of diversion ratios and profit margins as a
20 gauge of the upward pressure on prices.

21 I'll turn briefly to the list of other indicators.
22 Consistent with what is already in the OFT and CC
23 guidelines we mention that lack of alternatives for
24 consumers to switch to can be probative of a merger giving

1 rise to unilateral effects; for example, they can arise
2 because of switching costs. We mention that unilateral
3 effects theories of harm are often predicated on a lack of
4 reaction by rivals. Some of the models of competition that
5 I mentioned earlier essentially presume that rivals do not
6 react when the merged firm internalises the competition
7 between the two merger parties and does something
8 anti-competitive. We mentioned in our guidelines that
9 firms can undercut price, expand output in
10 undifferentiated product markets or reposition products in
11 differentiated good markets which is a form of efficiency.
12 In instances unilateral effects will be more likely where
13 firms are not able to react in that way, but we mention
14 that unilateral effects will be less likely where firms
15 are able to react to that.

16 The last of our indicators is that a merger involving
17 a recent entrant or particularly aggressive or novel
18 competitor could potentially be more problematic. In terms
19 of the economics this is an indicator that to some extent
20 is *sui generis* but it is quite well reflected in
21 decisional practice. That is all I have to say about
22 unilateral effects. Are there any questions?

23 MR WILLIAM SIBREE (Slaughter & May): I should like to ask the
24 OFT members of the panel whether this shift from market

1 definition focus in differentiated product markets is now
2 being reflected in the sort of evidence that is now being
3 asked for routinely in phase one cases.

4 MR WALTERS: That is probably a fair point. There are delegates
5 here who are probably better placed to answer that
6 question than I am. It is not that we necessarily subsume
7 market definition in horizontal mergers of differentiated
8 goods, but certainly it is not the be all and end all and
9 when it appears that the merger involves very
10 differentiated products other evidence, qualitative and
11 quantitative, of the closeness of competition that is
12 removed by the merger is something on which we concentrate
13 nowadays, and I think that is reflected in our recent
14 decisional practice.

15 MR SIBREE: If there are not such serious issues quite a heavy
16 burden is imposed on notifying parties if they have to go
17 through the whole business of getting robust econometric
18 evidence of diversion ratios.

19 MR WALTERS: The evidence needs to be robust but it does not
20 need to be econometric. There are other sources of this
21 kind of information including internal documents prepared
22 in the normal course of business that can be tremendously
23 informative about the closeness of competition between
24 merger parties and other rivals.

1 MR SIMON BISHOP (RBB Economics): I do not have a question but
2 really a comment. One of the very first assignments I had
3 in competition law was related to an OFT market definition
4 research paper in 1992, I think. That was set out because
5 they wanted to remove 'ad hockery' in market definition
6 and by imposing the principles of the hypothetical
7 monopolist or SSNIP test that went a long way to remove a
8 lot of the sub-sub-market definitions which were seen in
9 OFT and Monopolies and Mergers Commission decisions. I
10 think there is a real danger in reintroducing 'ad
11 hockery'. The real issue is that you are mischaracterising
12 the problem. The problem is not with market definition per
13 se. The SSNIP test itself is very well able and is
14 designed to cope with differentiated product markets. The
15 issue is concerned with the interpretation of market
16 shares. If you say that you do not need to do market
17 definition and you just jump to the answer because
18 otherwise you are wasting your time you are creating the
19 real probability that you will ignore really important
20 competitive constraints in the assessment. It is one thing
21 to say that the market shares associated with the
22 particular firms are overstated. Fine, but tell me why and
23 where it comes from, because the current approach and what

1 you are advocating raise a serious problem in terms of an
2 incomplete analysis and an ad hoc one.

3 MR WALTERS: I do not believe that my earlier statement that it
4 should not matter whether you frame a merger as one
5 generating high concentration in a narrow market or as one
6 between close competitors in a wider market, for the
7 purposes of unilateral effects analysis, is a
8 controversial one. I think the implication of it is that
9 there is a duality between the things. There is a duality
10 between measures of the closeness of competition and
11 their application in a SSNIP test and that duality has
12 been reflected in the kind of the critical loss analysis—I
13 am sorry to slip into jargon—for market definition that
14 the OFT has done in some recent decisions. I do not think
15 that in what we are doing we are abandoning the
16 hypothetical monopolist test as a tool for the competitive
17 assessment of mergers. What we are recognising is that
18 there is an interrelatedness between measures of the
19 closeness of competition and the application of the SSNIP
20 test. In those contexts if the route that leads you to
21 apply the SSNIP test is very convoluted and complicated
22 perhaps you should look at the flip side of the coin and
23 exploit the duality to focus on the closeness of
24 competition.

1 MR BISHOP: I do not want to monopolise the whole debate, but
2 another point is that even on your own analysis you have
3 market shares for competitors and a load of other factors
4 which are all presumed market definitions, so what you
5 intend to do is move from an explicit market definition to
6 an implicit one. Effectively, by doing that you are in
7 danger of ignoring some important competitive constraints
8 or not explaining why they are not there. From a practical
9 perspective it is just good discipline to take that step.

10 MR WALTERS: I did say in the market share numbers slide that we
11 agreed market shares were most informative for mergers in
12 undifferentiated product markets, but the application of
13 the SSNIP test can be more complicated in mergers
14 involving very differentiated products and in recognising
15 the duality between the two approaches it is perhaps more
16 prudent to apply the latter approach in those mergers than
17 to take a rigid market-definition/market-share approach. I
18 genuinely do not believe there is any tension there.
19 Provided you identify the aspects of competition and the
20 mode of competition in the market that describes those
21 properly and use that to categorise the evidence you are
22 asking for to my mind the two approaches are not
23 inconsistent.

1 CHAIRMAN: Does anybody else want to come in on that? From my
2 perspective we are definitely not trying to jettison
3 market definition or the need to define markets—far from
4 it. There is a big discussion in the guidelines about
5 market definition. If we were dropping it and going back
6 to random analysis we would not have such material in the
7 guidelines. What we are talking about is how we apply it,
8 in what order the various steps of the analysis take place
9 and how it is all knitted together. It is important not to
10 overstate the extent of the evolution.

11 MR JOHN COLLINGS (CC Member): I think that in the draft
12 guidelines the point is made that in a sense there is a
13 difference in this respect as to whether we are heading
14 towards an SLC or non-SLC finding. In a sense with a non-
15 SLC finding you are more likely to go down the road of
16 saying that the exact market definition does not make a
17 difference. I think that survived in the guidelines.

18 MR MAZZAROTTO: Given the effort that we put into making sure
19 our market definition methodology was one on which we
20 could rely to use market share as an appropriate way of
21 taking into account constraints on the supply side I think
22 it goes some way to reassure everyone that we do not
23 intend to do away with the process which, as you say, is
24 good discipline. We all agree that it is good discipline

1 to make sure decisional practice is consistent with the
2 SSNIP test methodology. It is a matter of recognising that
3 there are different sources of evidence and to ensure that
4 that consistency is true we want to ensure we take into
5 account all of the evidence that comes out of the
6 competitive assessment and do not apply in a mechanistic
7 fashion one or two-step procedure based on relatively
8 limited bits of information. We are just trying to do it
9 well, we hope.

10 CHAIRMAN: Does anyone else want to comment on unilateral
11 effects which are the killing ground for most merger
12 investigations? This is the central core of the
13 guidelines. Ominous silence! Does anybody else want to say
14 anything by way of explanation? I would be a little
15 concerned if it was thought that the purpose of the
16 revised formulation was to take away certainty and lay us
17 open to suggestions that it would not be possible to
18 predict how the analysis would go. That is absolutely the
19 reverse of the intention. We have come some way since
20 1992. I remember that time fondly. Some aspects have
21 become more certain and others less so but on the whole
22 the technique of analysis of these competitive effects
23 becomes much more sophisticated. It is possible to be much
24 more certain about how a particular analysis will be

1 carried out. I think you should see this very much as a
2 comparatively modest de-emphasising of a mechanistic
3 approach to market definition. I rest my case.

4 MS DEIRDRE TRAPP (Freshfields Bruckhaus Deringer LLP): Leaving
5 aside the great generation of work that the new approach
6 will create for GfK and their friends in the world of
7 surveys, will we get a little more clarity on how surveys
8 are to be done and when they are to be relied upon by both
9 agencies? A number of us have experiences of surveys being
10 done on which the OFT has relied heavily but have not met
11 CC's expectations. I think it would be useful if we had a
12 bit more information in that capacity.

13 MR WALTERS: As I understand it, the CC currently has a working
14 group looking at best practice on consumer surveys and
15 other quantitative techniques. I must emphasise that
16 consumer surveys are not the only way to get estimates of
17 diversion ratios. The CC working party is looking at that
18 kind of best practice. Perhaps Nicola can tell you a bit
19 more about it.

20 MR MAZZAROTTO: One thing to note is that perhaps there is an
21 element of trying to apply some methodologies at phase one
22 with some survey work to see if they work, but the field
23 of surveys is not one where we can rely on a very clearly
24 established practice from a theoretical and empirical

1 point of view. We are striving to get to a place where we
2 can be a little clearer in terms of what can be done when
3 and under what conditions. We are working towards that.
4 Whether or not we can build that into the guidelines is
5 something to be seen, but it is fair to say that we shall
6 be thinking about this.

7 CHAIRMAN: This falls fairly and squarely into the category of
8 getting the right allocation of tasks between the two
9 phases. We must be aware that this is a dynamic,
10 evolutionary process. The cry from business, as we
11 understand it, is that what can be done at phase one
12 should be done. The two authorities have obviously
13 discussed that and are not unsympathetic. There is a
14 danger of trying to do too much at phase one and getting
15 these techniques right and having clarity about the kind
16 of evidence that is appropriate, of which surveys are one
17 part, is part of the ongoing process. All I would say is
18 that this is something about which we are in discussion;
19 this is what we are consulting on and we shall listen
20 carefully to any feedback.

21 MR PETER DAVIS (Deputy Chairman, CC): First, there is ongoing
22 work within the CC to have a go at answering what are some
23 quite difficult questions about exactly how we get the
24 most reliable evidence on SSNIP and questions like it on

1 which we are focused. Second, both the CC and OFT are
2 dedicated to get both the existing learning in the
3 respective organisations across the organisations and also
4 to take on any new learning and imbed it in both
5 organisations so we are not in a situation where evidence
6 accepted at one stage is not acceptable at another.
7 Clearly, that is not the right outcome. We shall be
8 working to make sure that that is not the situation,
9 subject to the usual concerns. Obviously, the CC has more
10 time to look at these things than the OFT.

11 CHAIRMAN: Unless there are any other questions, I suggest that
12 we break for a quarter of an hour. Perhaps we can
13 reassemble at quarter to four by the accurate clock.

14 **REFRESHMENT BREAK**

15 CHAIRMAN: We turn to the next topic.

16
17 **CO-ORDINATED EFFECTS**

18
19 MR BOWDEN: As you have probably deduced already, I am from the
20 legal side of the room. If I was not aware of the debate
21 that co-ordinated effects induced in economists, it was
22 definitely brought home when I read the 101-page
23 transcript of the OFT/CC round table discussion on the
24 subject. From what I could deduce it seemed to me that

1 certain things were agreed and there were a number of
2 areas where there was disagreement as to whether there
3 would be any agreement at all. What we had to do was take
4 that round table and put it into our co-ordinated effects
5 section. Nicola will talk about the round table and what
6 we ended up putting into the guidance and I will just do a
7 quick run-through on some of the UK and overseas decisions
8 in relation to co-ordinated effects. The point to note
9 about the UK merger situation is that there have not
10 really been many co-ordinated effects cases. Since the
11 Enterprise Act the CC has not reached any SLC finding
12 based on co-ordinated effects although some cases have
13 been referred to it by the OFT based on co-ordinated
14 effects theories of harm. In many cases the OFT has left
15 open the issue of co-ordinated effects for the commission
16 to consider. There are really only three cases: Bricks,
17 Cardboard and Sugar where the commission has undertaken a
18 detailed co-ordinated effects analysis, although
19 ultimately the co-ordinated effects theory of harm was not
20 found to exist in any of those cases. In developing the
21 new draft guidelines we definitely reflected on some of
22 the overseas guidance and developments in recent cases,
23 most notably the Impala decision, ABF/GBI and recent cases
24 in the US. What those decisions show is that to establish

1 co-ordinated effects is not particularly easy and the
2 authorities need quite a coherent framework by which to
3 assess all the evidence, including both market conditions
4 and outcomes. I do not think there is the clear structure
5 that was being debated in relation to unilateral effects.

6 As Amelia pointed out, there is a broad formulation
7 of co-ordinated effects although in different cases they
8 were worded slightly different. We thought that we would
9 word it slightly differently ourselves. Nicola will go
10 into some of the background of how we set out our
11 formulation.

12 One thing that the two European cases provided was a
13 useful overview of the structure of a co-ordinated effects
14 analysis. In the ABF case DG Comp notes that the first
15 step is to consider market conditions to determine whether
16 they are conducive to tacit co-ordination, but it cautions
17 against a mechanistic approach to looking at these market
18 conditions. Therefore, you need to articulate a story
19 surrounding the likely mechanism for tacit co-ordination
20 and the likely degree of co-ordination that can be
21 expected in the absence of the merger. Finally, you need
22 to assess how the merger will make co-ordination either
23 more likely or effective, so you need to consider what
24 change the merger will make to the other two factors. I

1 will pass you over to Nicola to give you a bit more
2 background.

3 MR MAZZAROTTO: We have mentioned the round table a couple of
4 times. The transcripts should still be on the CC/OFT
5 website for your perusal. What we shall not attempt to do
6 is summarise the round table as a whole, even less
7 summarise the very rich and varied literature on the topic
8 in terms of practice, economic theory and the empirical
9 studies that have been conducted over the years. There are
10 some themes that we think it important to highlight that
11 arise from the round table in particular to help shape the
12 way we ended up drafting the consultation document. What
13 we learned from the round table was that, first, this is a
14 relatively new area in terms of theory, certainly if we
15 compare it with some aspects of unilateral effects theory
16 that go back to the 19th century, but on the plus side
17 aspects of this theory are relatively well accepted and
18 have performed well in practice. I am thinking primarily
19 about the theory of incentives to co-ordinate that forms
20 the basis for the necessary conditions for co-ordination
21 to take place; in other words, economics have been able to
22 provide a helpful way to assess whether and under what
23 conditions firms will find it in their interests to adhere
24 to a co-ordinated agreement or not. From that theory we

1 derive the conditions which are the same as those used in
2 various jurisdictions which can also be known as the 'Air
3 Tours conditions'.

4 The other thing to note which clearly emerges from
5 the round table is that the theory on co-ordinated effects
6 is different from that on unilateral effects in some
7 important respects. It does not really address some of the
8 issues that are relatively important to the finding of the
9 case which is the process of reaching an agreement. It is
10 often said it is important to look at all of the evidence
11 that is available in that respect and not to conduct it in
12 terms of some perhaps slightly esoteric theoretical
13 economic arguments.

14 The other point is the need to recognise that it is
15 not a binary (in/out) strategy; it is not a question of
16 moving from zero co-ordination to full co-ordination.
17 The reality of co-ordination is more complex than that and
18 co-ordinated outcomes can differ in terms of the
19 likelihood with which they will be sustained over time and
20 the price level they are able to sustain. It is important
21 that this variability of outcomes is recognised when one
22 comes to assess the effects that a merger can have on
23 prices or other variables that consumers then have to
24 face.

1 In simple terms what the theory does not do is
2 provide the same level of simple rules with respect to
3 market shares, for example, which we call comparative
4 studies. Unless the models are very specific and detailed
5 and therefore lose a little bit it is very difficult to
6 derive some general rules about higher market shares being
7 necessarily bad. That is why other issues such as symmetry
8 and generally seeing everything in the round is such an
9 important part of the assessment that we try, successfully
10 we hope, to incorporate in our draft.

11 The general point that emerges from some of these
12 issues is that the way to assess the validity of co-
13 ordinated effects theory of harm is by reference to a
14 fairly well developed story of how co-ordination will take
15 place in practice. It is not enough to refer to co-
16 ordination in the abstract; there needs to be some sense
17 of what competitive variables it would be affecting.
18 Clearly, that changes the way in which one would treat
19 some of the elements of the evidence. One example is the
20 role of symmetry. If you think about co-ordination in
21 terms of market sharing, for example geographical market
22 sharing, you may think differently about how important it
23 is that firms are of a similar size or have a similar
24 level of output or even costs in reaching your conclusion.

1 Bearing these things in mind, we think that the
2 framework we set out is very much in line with
3 international practice and is the one that Amelia set out
4 earlier in her slides. It is helpful to consider *these*
5 conditions. At the points of the triangle you have the
6 necessary conditions for co-ordination to occur in a
7 market. Clearly, in terms of analysing a co-ordinated
8 effects case if those conditions are met then the issue
9 becomes whether the merger can ensure that those
10 conditions are met in the post-merger scenario. If they
11 are then the issue becomes whether the merger makes co-
12 ordination more stable and easier for firms to reach a
13 higher level of price or they can co-ordinate better from
14 the point of view of other aspects of the offer. As Amelia
15 said, in terms of reach and monitoring co-ordination it is
16 helpful to look at that in the context of the ability of
17 firms to engage in co-ordination.

18 As to internal stability, we have in mind the
19 incentives to adhere to the agreement, in particular
20 whether there is a deterrent mechanism and what happens if
21 a firm deviates from the co-ordinated outcome. In a sense
22 it covers the issue of incentives. Finally, the condition
23 of external stability is whether the co-ordination would
24 have an effect, that is, whether they would be able

1 | meaningfully to co-ordinate to worsen the competitive
2 | outcome in some shape or form. Essentially, what that
3 | means is assessing whether the co-ordinated firms as a
4 | whole have enough market power to wield in the market;
5 | that is, whether entry constraints could be expected to be
6 | strong enough essentially to undermine any co-ordinated
7 | effort.

8 | What we sought to recognise in our guidance is the
9 | fact that there are some scenarios where we believe on the
10 | basis of the theory in place and the empirical work that
11 | has been done and the practice as it has accumulated over
12 | the years it is probably important to recognise that there
13 | are two scenarios where we would be particularly concerned
14 | by a merger in terms of its ability to lead to co-
15 | ordinated effects. One is the case where we believe that
16 | in the market there has been a history of attempted but
17 | not necessarily successful co-ordination. That is because
18 | of the fact that co-ordinated outcomes are by their nature
19 | always a little imperfect. It is often the case that
20 | unless the merger leads to a situation where the
21 | incentives are no longer aligned either because it raises
22 | asymmetries in a very significant fashion or because of
23 | other reasons it is likely that it will make co-ordination
24 | stronger and more stable just by making the market

1 structure more symmetrical and reducing the number of
2 competitors. The role of high concentration asymmetry is
3 also one that we thought was important to recognise. When
4 we get two markets where there are two or three firms that
5 are fairly symmetric the risk of them being able to
6 recognise their interdependence and align their behaviour
7 in a way that reduces competition is a significant one.
8 Under the heading we also pick up the danger of mergers
9 that eliminate players. For example, a new competitor is
10 sometimes called the maverick; it goes under that
11 particular heading. I will leave it at this point. That is
12 the general framework.

13 CHAIRMAN: Lots of guidance but rather few cases! Are there any
14 questions or comments?

15 MR JEREMY SIMON (Norton Rose LLP): I just want to check whether
16 the authorities have adopted a position where the three
17 conditions are now not just necessary but of themselves
18 sufficient. There is a statement in the guidelines that a
19 merger in a market with two or three similarly sized firms
20 in which the three conditions are met may well be
21 considered to give rise to an SLC.

22 CHAIRMAN: What is the reference?

23 MR SIMON: It is paragraph 4.122.

1 MR MAZZAROTTO: I think that is one of the two situations where
2 we try to highlight that fact. I do not think we are
3 saying that they are sufficient. Clearly, we want to look
4 at what the merger does to the market context, but if by
5 looking at the post-merger scenario we are in a situation
6 such as the one you describe as specified in that
7 paragraph I think the message is that the reduction in the
8 number of competitors and the increasing symmetry that
9 that might bring about is something that we would take
10 very seriously.

11 CHAIRMAN: It is clearly not a per se rule; the argument is over
12 what is meant by 'may well' as opposed to 'may'. We
13 encourage you to read 4.122 in context. Bearing in mind
14 its position in the section on co-ordinated effects as a
15 whole I do not believe that the question you ask is our
16 position. We may have to look at the wording just to make
17 sure that we are not giving an erroneous impression that
18 we are giving a 'tick in the box' approach.

19 MS FLETCHER: I think we are a little loose with our 'may well',
20 'is likely to', etc. We need to go through the whole
21 guidelines with this in mind.

22 CHAIRMAN: You will have a glossary at the back saying 'may
23 well', and so on—or 'may not'?

1 MR SIMON BISHOP (RBB Economics): I have a question that relates
2 to existing co-ordination. Given that a lot of market
3 outcomes which might be consistent with existing tacit co-
4 ordination can also be consistent with effective
5 competition, it raises the difficulty of how to
6 discriminate between those two outcomes. Are there any
7 thoughts on how you would do that?

8 MR MAZZAROTTO: I will have a stab at that. That is clearly an
9 important issue particularly in the context of the recent
10 EC cases, in particular Impala. I do not think we have a
11 clear set of rules as to how we go about doing that, but
12 when we are thinking about evidence of pre-existing co-
13 ordination we certainly do not have market outcomes as the
14 sole matter we have in mind; indeed, we would be very
15 careful in treating evidence about pricing or other
16 evidence of market outcomes in isolation to draw an
17 inference from that alone without making sure we had other
18 forms of evidence to suggest that it is co-ordinated
19 behaviour that we are talking about. It is one of those
20 cases where we would be very careful in conducting an all-
21 round approach.

22 MS FLETCHER: We were thinking more about explicit co-ordination
23 in terms of evidence of pre-existing co-ordination. In
24 that case we are thinking about explicit documentary

1 evidence, but even then it is very difficult. For example,
2 we have had mergers where we have had leniency
3 applications. Obviously, such applications are entirely
4 confidential. We are then in a very difficult position. We
5 think we know things on the basis of those leniency
6 applications but we cannot necessarily make use of that
7 information, so it is very tricky. Sometimes, counter to
8 that, an industry has been through an entire cartel
9 investigation, been found guilty, fined etc and then it
10 says, 'Well, just because we did it in the past doesn't
11 mean we will ever do it again. We've learned our lesson
12 and you can't now stop us merging on the basis that in the
13 past we engaged in that behaviour.' There are arguments in
14 favour of that point as well. This is a very difficult
15 area and we must see how we apply it in practice, but
16 views are very welcome.

17 MR GAVIN ROBERT (Linklaters): I have a couple of comments on
18 the first point raised by Simon. There was a very useful
19 paragraph in the previous CC guidelines on the difficulty
20 of distinguishing between competitiveness and co-ordinated
21 outcomes. It is one that I have cited in several previous
22 cases to various regulatory authorities, so if that is
23 being purposefully deleted from my point of view that
24 would be a shame.

1 CHAIRMAN: If it has been deleted by accident that is all right,
2 is it?

3 MR ROBERT: The second point is on the relevance of previous
4 cartel behaviour. I think that in various guidelines
5 around the world this is thrown in as a relevant factor
6 without any more sophisticated analysis of how you
7 determine its relevance. I would argue that the existence
8 of a previous cartel could be evidence of the unlikelihood
9 of tacit co-ordination by the parties and you have to look
10 at the individual cartel circumstances in order to reach a
11 view on the relevance of the previous cartel. Therefore,
12 if the previous cartel was one where they had specifically
13 put in place illegal information-sharing mechanisms and
14 some form of cartel manager to operate the cartel—because
15 otherwise the market would be insufficiently transparent—
16 that may be the best evidence you could get that the
17 market is not susceptible to tacit co-ordination. I know
18 there are lots of other guidelines around the world that
19 make this statement which in some sense is a glib one
20 without much more sophisticated analysis. It would be a
21 shame if in looking at this area you did not engage in a
22 slightly more sophisticated analysis of when cartel
23 behaviour was and was not relevant.

1 MR MAZZAROTTO: We agree with that. I guess that is why those
2 scenarios are in the middle of the triangle surrounded by
3 those helpful conditions on the outside. This is very much
4 something that we consider in the context of the overall
5 assessment and certainly not in isolation. I take your
6 point about the fact that explicit and tacit co-ordination
7 are not necessarily substitutes.

8 CHAIRMAN: The paragraph you have in mind is 3.43, is it, which
9 starts, 'However, identifying co-ordinated effects is
10 difficult. . .'?

11 MR ROBERT: I do not have the reference.

12 CHAIRMAN: It is the old one; it is the last one.

13 MR ROBERT: I am afraid I do not have the reference in my head.

14 CHAIRMAN: I thought there was so much in the present
15 formulation that makes it clear that identifying co-
16 ordinated effects is difficult, but we will have a look at
17 that to see whether or not we have the difficulty
18 sufficiently clear.

19 MR JONATHAN GREEN (Europe Economics): Given the difficulty of
20 reaching findings on co-ordinated effects and the
21 variability of outcomes to which you refer, is there a
22 danger of a type of Goodhart's law operating where if you
23 do identify indicators that you think are useful in
24 helping you to define the circumstances the very fact of

1 defining them means they become less valuable as
2 indicators and the action moves elsewhere? Just because
3 this is such a complex area maybe trying to get greater
4 precision means that the life of competition authorities
5 is made more difficult in the long term.

6 CHAIRMAN: I fear that is our burden. I am sure that as an
7 observation that is very true. My impression is that our
8 task becomes more difficult every week as we strive to do
9 a better job, but I am afraid that is life.

10 MR MAZZAROTTO: That really lies behind our attempt to identify
11 some scenarios where we think that on balance, not just on
12 the basis of a few models of economic theory, looking at
13 the practice and empirical evidence over the years
14 everything that we know about co-ordinated effects tries
15 to put us in a position to reach the right balance between
16 being able to address those issues and building a case
17 that stands up on the basis of the evidence. It is a
18 difficult job.

19 CHAIRMAN: We will try to avoid 'ad hockery' anyway.

20 MR PETER DAVIS (Deputy Chairman, CC): I want to say a word
21 about distinguishing co-ordination from competition. As
22 many in the room will know, this is an active area of
23 progress in the academic economics world. Some of the
24 lessons have been brought into practice, some have not.

1 But as guidance for what we would do, let me say that we
2 would take that fairly well understood broad branch of
3 economics, starting off with the likes of Tim Bresnahan in
4 the early 1980s and moving on through authors such as Rob
5 Porter and more recently Pat Bajari and others. All of
6 that work to ask the question: what is the data variation
7 that allows you to distinguish competition from
8 co-ordination? Some of the answers are not immediately
9 obvious, for example the answers involve things like
10 demand rotations. Nonetheless, that literature would be
11 the basis of the effects-based economic analysis that you
12 would undertake in a given case. Obviously, in the
13 interpretation of the conditions and how that feeds into
14 whether or not there is an SLC in a merger there will be
15 elements of judgment as well, but the basic problem of
16 distinguishing pricing patterns which are the result of
17 competition and those which spring from co-ordination is a
18 difficult but not impossible economic question on which
19 data and theory can be brought to bear, and the match
20 between the institutions on a given case and the theory
21 obviously needs to be made clear.

22 For a survey there is a rather nice piece by Joe
23 Harrington quite recently which looks at these branches of
24 literature. Basically, that is what we would do; we would

1 look at the economics literature and take the lessons from
2 it and use them to allow us to distinguish between co-
3 ordination and competition to the extent we can. There are
4 limits. There are some parts of that theory that are not
5 yet well developed, but there are substantial areas of it
6 which are now well-trodden territory.

7 MR ADRIAN MAJUMDAR (RBB Economics): Paragraphs 4.13 to 4.15 are
8 intriguing. They start off by saying: 'The Authorities
9 thus consider it is possible for a merger to lead to both
10 unilateral and co-ordinated effects on the same aspects of
11 competition.' For example, on price we could have a
12 unilateral effect and a co-ordinated effect. It then goes
13 on to say: 'The Authorities may not need to form a view of
14 the likelihood of both theories of harm if they expect one
15 of them to be sufficient.' I can understand why at the OFT
16 stage you may have a view that both can be credible and
17 therefore there is a referral issue. I am just wondering
18 whether this suggests that at the stage of the Competition
19 Commission it could be said, 'Well, there's a 30% chance
20 of a unilateral effect and a 25% chance of a co-ordinated
21 effect, so on balance that is a problem.' If not, what are
22 the examples where both a unilateral effect and a co-
23 ordinated effect occur?

1 MR MAZZAROTTO: First, what we mean in paragraph 4.13 is that if
2 we expect one of them to be sufficient to meet the
3 competition test that means, for example, we think it is
4 more than likely that there will be unilateral effects.
5 That is the likely scenario. We perhaps cannot rule out
6 that there will be co-ordinated effects on top of that,
7 but we think the likely scenario is unilateral effects. I
8 think that is just there to say that we do not necessarily
9 feel we have to form too narrow a judgment as to what we
10 are able to predict in terms of the likely market outcome.
11 What we need to show is that there is an expectation that
12 there will be harm to consumers in one way or the other.

13 CHAIRMAN: That is absolutely right. We do not intend to play
14 percentage gymnastics but to work out what would be the
15 most effective and pragmatic theory of harm to
16 investigate.

17 MS FLETCHER: Reading it, I do not think it is entirely clear
18 and we should address that sentence, but we do not intend
19 to say that the merger could result in both theories of
20 harm on the same aspect as the same time. I think that
21 what we mean to say is that some mergers could lead to
22 either and it may not necessary for us to determine which
23 of the two is the more likely if at least one of them is
24 very likely.

1 CHAIRMAN: That is absolutely right. That was what I was trying
2 to say very inadequately. Can we move on now to the last
3 topic?

4
5 **NON-HORIZONTAL MERGERS**

6
7 MR WALTERS: Our guidelines on non-horizontal mergers are
8 borrowed from the European Commission's excellent non-
9 horizontal merger guidelines. Our guidelines recognise
10 that the commercial rationale for non-horizontal mergers
11 is generally efficiency enhancing. An exception here would
12 be diagonal mergers which warrant only a brief mention in
13 the guidelines. I believe they are quite novel and I will
14 talk about them briefly at the end. However, what is
15 unusual about recent UK case law is that many 'verticals'
16 have been horizontal mergers with vertical effects; they
17 have not been purely vertical mergers in the sense of some
18 of the very high profile EC vertical mergers of recent
19 years. Unlike purely vertical mergers and conglomerate
20 mergers, these may not be naturally as efficiency
21 enhancing, but set against that the focus of attention
22 that we mention in our guidelines will be on the
23 horizontal harm, not necessarily the vertical harm.

1 What has permeated the way we have written the
2 guidelines on non-horizontal mergers is the lack of
3 suitably general models of vertical and conglomerate
4 foreclosure and that implies a need in some sense to
5 future proof the framework, by which I mean that all non-
6 horizontal mergers involve different markets that can have
7 different modes of competition, which was part of the
8 language I used earlier in the context of unilateral
9 effects. These markets will have linkages between them.
10 Therefore, the notion that there is some sort of very
11 general model of non-horizontal mergers is not really as
12 strong as it is when looking at horizontal models of
13 competition and unilateral and co-ordinated effects. I
14 think that implies in some sense a need to future proof
15 the framework.

16 The framework we have chosen is the EC's ability
17 incentive and effect framework but, unlike the quite well
18 structured flow chart approach that I described under
19 unilateral effects, here we have a Venn diagram. That can
20 be contrasted with the much more structured flow under
21 unilateral effects. As Amelia explained earlier, the EC's
22 framework looks at ability which typically will depend on
23 market power, which I shall go on to discuss; the
24 incentive to foreclose in the vertical or conglomerate

1 sense, which will depend on whether such foreclosure is
2 profit-enhancing; and the effect on competition, not just
3 competitors, allowing for efficiencies.

4 Our guidelines also explicitly draw a distinction
5 between the application of this framework at phase one,
6 the OFT stage, and phase two. Given a realistic prospect
7 of an ability to foreclose and a realistic prospect of an
8 incentive to foreclose, the OFT may presume anti-
9 competitive effects. The OFT may look at any form of total
10 or partial input or output foreclosure or conglomerate
11 effects tying or bundling and, if it finds a realistic
12 prospect of the ability and incentive to do that, it may
13 not necessarily need to say which of the particular forms
14 of foreclosure it thinks is most likely but may presume an
15 anti-competitive effect. Conversely, the CC will not do
16 that. Notwithstanding the fact that it would not be bound
17 by the OFT's finding under the realistic prospect test on
18 ability and effect, the CC will instead attempt to look at
19 what it thinks is the appropriate foreclosure strategy and
20 then assess the effect of that strategy. Therefore, there
21 is an explicit distinction in the guidelines between the
22 first phase and second phase approaches.

23 Another sense in which we try to future proof the
24 framework is by talking about things in the more general

1 sense, if you like in the Venn diagram sense. We have not
2 said as much about non-horizontal effects per effect if
3 you like as we have done about other effects. To give a
4 simple example, the section in our guidelines on
5 unilateral effects that I described earlier is five pages
6 long; the section on co-ordinated effects is three pages
7 long; and this section is seven pages long but it covers
8 four different types of effect. Therefore, the 'per
9 effect' wordage, if you like, is proportionate to the
10 frequency with which these sorts of effects come up in
11 case work.

12 To turn to ability to foreclose, typically this will
13 depend on whether the merged firm has market power. Here I
14 have highlighted a market share 'threshold'. In a purely
15 vertical merger we have borrowed the European Commission's
16 30% market share threshold, but we do not have as much
17 emphasis on this as is in the Commission's non-horizontal
18 merger guidelines. Moreover, we explicitly mention that in
19 horizontal mergers with vertical effects, of which there
20 have been a lot in the UK, only a degree of market power
21 significant enough to cause unilateral effects will cause
22 concern over vertical effects. That may not be 30%.

23 We also say that the ability to foreclose typically
24 depends on whether or not the firm has market power and

1 that can arise because it controls an important input, so
2 it is not just a simple measure of market share. We say
3 that an important input is one that if foreclosed would
4 adversely affect the competitiveness of the merged firms'
5 rivals.

6 We go on to the second of the three circles in the
7 Venn diagram: incentive. This depends on whether
8 foreclosure is profit-enhancing. Whether or not that is
9 the case depends on a trade-off between the profit lost
10 from selling less in the market where the merged firm
11 leverages its market power—so, in the case of input
12 foreclosure that arises from selling less of the input; in
13 the case of customer foreclosure it arises from selling
14 less through this route to market; and in the case of
15 conglomerate foreclosure it arises from selling less of
16 the tying good because people prefer not to buy it as part
17 of some sort of bundle—and, on the plus side of the
18 ledger, the profit gained from selling more/at a higher
19 price in the market where the merged firm forecloses its
20 rivals. We explicitly discuss that trade-off. However, our
21 guidelines have a limited role for what is called
22 'vertical arithmetic' especially at first phase, but we
23 use those aspects heuristically in the guidelines. Part of
24 the reason we have a limited role for vertical arithmetic

1 is that the factors that go into the very literal
2 arithmetic calculation hold true only in quite a small
3 number of cases. We appeal to the intuition of the
4 vertical arithmetic but what we do not do is emphasise it
5 particularly strongly as an analytical approach.

6 Referring to the last circle in the Venn diagram-
7 effect-as Amelia explained earlier this is the effect on
8 competition, not on one or just a few competitors. As I
9 explained, given the incentive and ability the OFT may
10 presume effect. It may look at a range of foreclosure
11 strategies. If it finds incentive and ability it may say
12 that one or more of those may have an anti-competitive
13 effect. Conversely, the CC will not do that. Not only will
14 it not take the OFT's findings on ability and incentive as
15 given; it will instead look at what it thinks is the
16 appropriate foreclosure strategy and assess the ability,
17 incentive and effect of that strategy. Recognising that in
18 both the first and second phase approaches non-horizontal
19 mergers are often efficiency-enhancing, there is always a
20 role for supply-side efficiencies, subject to the normal
21 evidential threshold for efficiencies: that they are very
22 likely to arise and will be timely, by which I mean they
23 are commensurate with the onset of any harm; that they are
24 merger-specific; and that they are passed on to customers.

1 To mention the extra single paragraph on diagonal
2 mergers, essentially in our guidelines we characterise it
3 as a vertical merger that is not as likely to give rise to
4 efficiencies. Just to give you a practical example of what
5 I am talking about—I am grateful to Mark Williams of NERA
6 for suggesting it to me—the vertical merger here involves
7 a sugar beet farm which supplies beet to be refined and
8 the refined beet sugar then competes in the market with
9 refined cane sugar. An increase in the sugar beet price
10 can therefore increase the demand for refined cane sugar.
11 A diagonal merger between the sugar beet farm and the
12 sugar cane refinery indicated by the dashed line could
13 therefore internalise this competition. This will have an
14 anti-competitive effect only if: sugar beet is a very
15 important input to refined beet sugar, which it probably
16 is in this particular example but need not be all the
17 time; the sugar beet farm has market power; and refined
18 beet sugar and cane sugar compete very closely, which
19 again in this example they probably do, but this need not
20 always be the case. I do not want to over-emphasise
21 diagonal mergers but it is new and there is a paragraph in
22 the guidelines about that.

23 That is the end of my brief tour of non-horizontal
24 mergers.

1 CHAIRMAN: Are there any comments on that aspect or non-
2 horizontal mergers generally?

3 MR JONATHAN GREEN (Europe Economics): For clarification, you
4 mentioned the 30% 'threshold' for vertical links. One of
5 the earlier slides in the section on unilateral effects
6 talked about a 40% share where problems may start to
7 arise. I was not quite clear from what you said how the
8 two were related.

9 MR WALTERS: They are related in the sense that in a purely
10 vertical merger we do not have a horizontal concentration.
11 There has been no assessment of market power at the
12 horizontal level, so, borrowing from the Commission's non-
13 horizontal merger guidelines, we say that it is not very
14 likely that we will find market power in that purely
15 vertical sense unless one of the firms has a 30% market
16 share. Conversely, we say in the section on horizontal
17 unilateral effects that in cases where there is a
18 horizontal merger previous decisional practice of the OFT
19 suggests that unilateral effects are less likely with
20 combine market shares of 40%. I think you are right to
21 point it out. We do not know whether or not there is some
22 tension there, but in the context of the 40% share that
23 would be a horizontal merger with vertical effects. The
24 30% share in this instance would be a purely vertical

1 merger, but we did discuss whether there was value in
2 harmonising in some sense those share thresholds. You will
3 remember that in the section on unilateral effects we say
4 we are less likely to find harmful effects below 40% but
5 we certainly would not rule that out. Here we are being
6 more generous to purely non-horizontal mergers where you
7 do not have the horizontal effects at all.

8 MR ROBIN NOBLE (Oxera): I make a comment specifically about
9 this session but perhaps it goes a little broader as well.
10 In formulating these guidelines there is a tough trade-
11 off. You want them to be relevant and draw on best
12 practice as informed by cases, but you also want it to be
13 long lasting, so the question that struck me as I was
14 reading the document and also listening to these sessions
15 was whether or not what we have here is a very fashionable
16 document—certainly, diagonals are very fashionable—but the
17 question is: will that be a timeless classic or consigned
18 to the flares of history, as it were?

19 There are a couple of things floating around in my
20 head both from reading and what I have heard today. One
21 is: where are we going with market definition? This is a
22 slight departure from the historical path for the past few
23 years. Referring to earlier comments, it strikes me that
24 there are a lot of very recent cases in there. Naturally,

1 one will refer to recent cases but one wonders whether we
2 should have a few more classics, if one can really call
3 cases 'classics'? Is it the right length? Is it too long?
4 Maybe it is. Classics are often quite short. Maybe it does
5 need that length to go into the depth and detail required
6 to explain the complexities of what is going on, but, as
7 you have said, sometimes it is better to say little or
8 nothing at all because the debate is ongoing and if one
9 pins one's colours to the mast too early one may come to
10 regret it. It is a thought on which I have not really
11 reached a conclusion, but I wonder whether it is something
12 that can be ruminated upon by the panel.

13 CHAIRMAN: We will ruminate. The next question will probably be
14 the last.

15 MR DAVID PARKER (Frontier Economics): I have one question on
16 market share thresholds. In the guidance it seems that you
17 have a 30% share in one market as a minimum before you
18 start to become concerned, but is there not also a role
19 for a share threshold in the other market in that your
20 concern is that a reasonably strong position in one market
21 may lead to a diminution of competition in another? If you
22 have only 1% or 2% in that other market do you really want
23 to go into lots of complicated vertical thresholds? Should

1 we not have a further threshold to screen out those sorts
2 of cases?

3 MR WALTERS: The answer to that is yes. It is not described as a
4 market share threshold but there needs to be enough of a
5 market presence in the market that is being foreclosed so
6 you enjoy enough diversion to your products in that market
7 to make it worthwhile to foreclose. That is not expressed
8 in terms of a market share threshold but that is the
9 underlying logic. You need a sufficiently significant
10 presence that if you foreclose the product you pick up the
11 business to make that worthwhile.

12 MR MAZZAROTTO: That may not necessarily be something you are
13 able to assess on the basis of pre-merger shares. I guess
14 there must be an expectation that you will gain in the
15 downstream market from your foreclosure strategy. That is
16 not necessarily something you can always deduce from your
17 pre-merger share by definition. That is what you are
18 trying to ameliorate in a sense.

19 MR PARKER: It is surprising to me that you would not feel
20 comfortable with a *de minimis* threshold of, say, 5%.

21 MS FLETCHER: That is something we should think about. I know
22 that it is also being thought about in respect of the
23 vertical guidelines under 81. Part of the reason for the
24 30% test here is for consistency with those guidelines.

1 Obviously, if they are to end up with market shares at
2 both levels then possibly it makes sense for us to look at
3 the same thing. We will take that away.

4 CHAIRMAN: It is after half-past four and I think I shall draw
5 this to a close. First, I thank our presenters and
6 analysts for taking the time and effort to explain to you
7 some of the thinking behind the guidelines. I also thank
8 you for turning up, listening and engaging in the
9 consultation. We carefully note the queries and points
10 that have been made. We were trying to stress that this is
11 a genuine consultation. The fact that it is a joint
12 publication we regard as very valuable. We have agreed on
13 the text which in itself is, we hope, a considerable help
14 to the marketplace. There are various areas where OFT and
15 ourselves will do things in slightly different ways. That
16 reflects our different timing and slightly different
17 tasks. We shall take away and consider the various queries
18 that have been raised: the significance of being first
19 past the post; the point about the percentage threshold
20 for the hypothetical monopolist test; the danger of moving
21 too far away from a market definition and framework and
22 towards arbitrary and unpredictable analysis; increased
23 emphasis on survey work at phase one, and whether this
24 fits in with the allocation of tasks; the difficulties

1 involved in co-ordinated effects; greater clarity in
2 relation to cartel behaviour; how we tell the difference
3 between competition and co-ordination; and the fact that
4 we would not aim necessarily to apply both theories of
5 harm in relation to unilateral and co-ordinated effects to
6 the same situation at the same time.

7 As to the question raised at the end about whether
8 this document is too long, whether it is a classic and
9 whether it is intended to be set in concrete, the answer
10 is clearly no and that is how it should be seen. We have
11 had guidelines since 2003. The first guidelines were
12 written on the basis of no directly relevant case
13 experience at all, so all the cases and doctrines are by
14 analogy with previous practice or the practice of other
15 authorities. We have since had six years of actual
16 experience and we can hardly be blamed for sprinkling a
17 few recent cases. If you regard six years as 'recent' then
18 all cases are recent by definition. We are sprinkling a
19 few of those around in order to help the reader relate
20 these rather abstract propositions to some real material.

21 I hope we have emphasised in the accompanying
22 material—I certainly do so again if it is called for—that
23 this is an evolving picture; it is a fluid document. We
24 will publish new ones from time to time, but practice

1 evolves and we have to keep our guidelines up to date. The
2 CC like the OFT has a constant process of going over each
3 aspect and testing them against current practice, problems
4 and issues and seeing whether or not they hold water.
5 Inevitably, what you get is an attempt to update the
6 previous volume and in turn it will be updated surely. I
7 do not think we are trying to enact now guidelines for the
8 next 50 years; to do that would be hopelessly optimistic.
9 It is meant to be a living document. As to whether it is
10 too long or too short I leave to you. It is a thundering
11 good read, particularly if you suffer from insomnia.

12 On that note, thank you very much and goodbye.

13 *(Applause)*

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