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Goldilocks in a bear market

The quest for the 'just right' balance in UK merger control

All views personal and not necessarily those of the OFT

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Outline

Goldilocks and ...

- ... the post-IBA porridge
- ... the graphic equalizer
- ... supermarket challenge!
- ... tuning into efficiencies
- ... the tripartite authorities

Balancing issue

Phase I and II

cost/benefit of Phase II

remedial over- vs.
under-enforcement

pro- and anti-
competitive effects

competition policy
and public policy

Lead Phase I case/s

BSkyB/ITV, BBC/ITV/C4 - JV

BOC/Ineos, Nufarm, et al

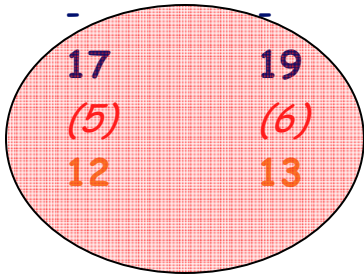
CGL/Somerfield, Celesio v OFT

Global/GCap

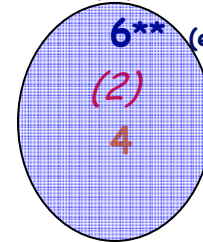
Lloyds TSB/HBOS

Porridge thermometer - Phase I and II

| 'Intensive OFT look' set | '04 | '05 | '06 | '07 | '08 ytd | (calendar) |
|----------------------------|-----|-----|-----|-----|---------|------------------------|
| Total CRM cases | 28 | 35 | 29 | 27 | 22 | |
| Realistic prospect of SLC | 23 | 23 | 19 | 19 | 16 | |
| ▶ 'clear-cut remedy' (UIL) | (6) | (4) | (7) | (5) | (6)* | (* incl. GHG/Nuffield) |
| ▶ exempt (de minimis) | - | - | - | (2) | (3) | |
| ▶ OFT refers to CC | 17 | 19 | 12 | 12 | 6** | (excludes Lloyds/HBOS) |
| ▶ cancelled inquiries | (5) | (6) | (2) | (4) | (2) | |
| ▶ net CC inquiries | 12 | 13 | 10 | 8 | 4 | |



TOO HOT!



TOO COLD!

'The reference test is far too low'

The antitrust bears →
(ursus antitrust-us)



'The OFT is eating all the porridge!'

'I suggest you merge while the going's good'

System balance – Phase I and II

| 'Intensive OFT look' set | '04 | '05 | '06 | '07 | '08 ytd (calendar) |
|---------------------------------|-----------|-----------|-----------|-----------|--|
| Total CRM cases | 28 | 35 | 29 | 27 | 22 |
| Realistic prospect of SLC | 23 | 23 | 19 | 19 | 16 |
| ▶ 'clear-cut remedy' (UIL) | (6) | (4) | (7) | (5) | (6)* (* incl. fix-it-first GHG/Nuffield) |
| ▶ exempt (de minimis) | - | - | - | (2) | (3) |
| ▶ OFT refers to CC | 17 | 19 | 12 | 12 | 6# (# excl. Lloyds/HBOS) |
| ▶ <i>cancelled inquiries</i> | (5) | (6) | (2) | (4) | (2) |
| ▶ net CC inquiries | 12 | 12 | 10 | 8 | 4 |
| → 'SLC' subset | | | | | |
| % 'binary' (CC block or clear*) | 74 | 83 | 63 | 63 | 44 |
| % 'fixable' (UIL) | 26 | 17 | 37 | 26 | 38 |
| % 'de minimis' | - | - | - | 11 | 19 |

4x rail franchise bids (2 cancelled, 1 hypothetical)
2x refs for LSE bids = 1 large CC inquiry

Binary = OFT believes the CC will either block the deal (or impose very substantial or complex remedies) or clear the deal, based on new evidence and/or the higher intervention threshold applicable (CC's balance of probabilities vs. OFT's realistic prospect)

Fixable = competitive problems are 'severable' (e.g. stand-alone retail assets) and small proportion of deal

System balance by SLC theories: Jan '06 - Oct '08

| 2 to 1 ~ 'monopoly' | #1 and #2 ~ 'dominant firm' | 3 to 2 | 4 to 3 | Other theory of harm |
|---|---|---|--|---|
| <i>Nufarm/AH Marks*</i> | <i>Kangaroo JV*</i> | <i>BOC/Ineos*</i> PF SLC | <i>Long Clawson/Mill.*</i> | BSkyB/ITV (strategic leverage) EWS/Marcroft (vertical – defensive) |
| Arqiva/NGW Sportech/Vernons (Greif/Blagden) PF SLC Kemira/Terra Thermo/GVI Svitzer/Adsteam Stagecoach/Citylink MDA/Quest Safenet/nCipher | (Game/Gamestation) 2:2 Stonegate/Deans Hamsard/Academy Panfish/Marine Harvest Stericycle/STG <i>Hospedia/Premier</i> Killarney/Balmoral IPC/Horse Deals | Woolworths/Bertram CBS/Hampden Polypipe/Verplas G4S/Abbotshurst | Tesco/Slough Wienerberger/Bag. <i>Cineworld/W Green</i> CGL/United Aggregate I./FY Pendragon/Vardy | Aggregate I./FY (JV links duopoly) CGL/Fairways (unilateral, 25% rule) |
| DPL/Berkshire News CGL/United Inchcape/EMH Flybe/BA Connect Pendragon/Vardy Tetra Laval/Carlisle Gala/County Boots/UniChem FMC/ISP | Global/GCap Air France-KLM/VLM Transocean/GSF Johnston/Local Press | Homebase/Focus Lloyds Pharm/IPCC Aggregate I./FY Pendragon/Vardy Boots/UniChem Stagecoach/Cavalier | KEY Phase I remedies Phase II abandon Phase II remedies Phase II clear (Close call clear) Phase I de minimis * pending | (rail franchise cases) Nat'l Exp/ICEC Arriva/XC Stagec'h/E Mids |

Error cost analysis

- **BSkyB / ITV** – 17.9 pc stake by #1 in pay-TV in #1 commercial free-to-air TV player
 - Risks – market power in £10 bn TV market vs. no lost efficiencies or chilling effect
 - Marginal referral to the CC → Phase II divest to below 7.5% → CC upheld on SLC appeal
- **BBC / ITV / Channel 4** – ‘Kangaroo JV’ in VOD merges #1 & #2 content archives for UK-origin TV
 - Risks – durable market power in fast-growing consumer VOD (*if JV is anticompetitive*) vs. 6 month delay to pro-competitive trilateral JV in evolving market (*if JV is benign*)
- Small market, low probability of harm – low type II error cost (*Stagecoach/Cavalier*)
- Potential competition – easy to speculate, risk of type I error (*Air France-KLM/VLM*)
- The upside to the OFT’s unique *de jure* variable intervention threshold: calibrating concerns and acknowledging error cost

Materiality thresholds

The de minimis 'graphic equalizer'


- Size of market £0m ----- £5m ----- £10m
- Probability of harm 0% ----- 50% ----- 100%
- Magnitude of effect Low ----- Av ----- High
- Durability Short ----- Med ----- Long
- Deterrence multiplier Zero ----- Av ----- High

- Volume 0-----11



Materiality thresholds

Key points

- Graphic equalizer is sense check to qualitative proportionality (cost/benefit) judgment
 - Deterrence – market power as driver, applicability to other deals (survey: 5:1 effect)
 - Easy divestiture remedy cases do not get exemption
 - De minimis chances: cf. relatively low probability event in small market vs. textbook anticompetitive deal caught by the merger regime
 - 5 cases – exemption applied to realistic-but-below-50%-likely SLC concerns, markets of <£1m - £3m
 - 2 cases – exemption not applied to SLC well above 50% likely, based on 70-100% share, big delta, unreliable entry. Markets of ~£5m, but ... deterrence
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First-phase remedies

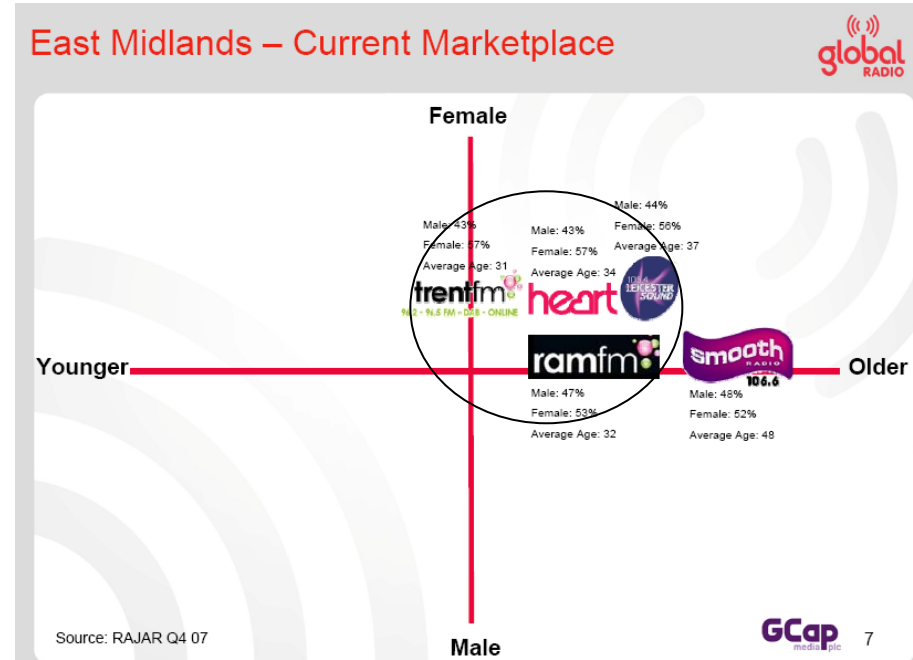
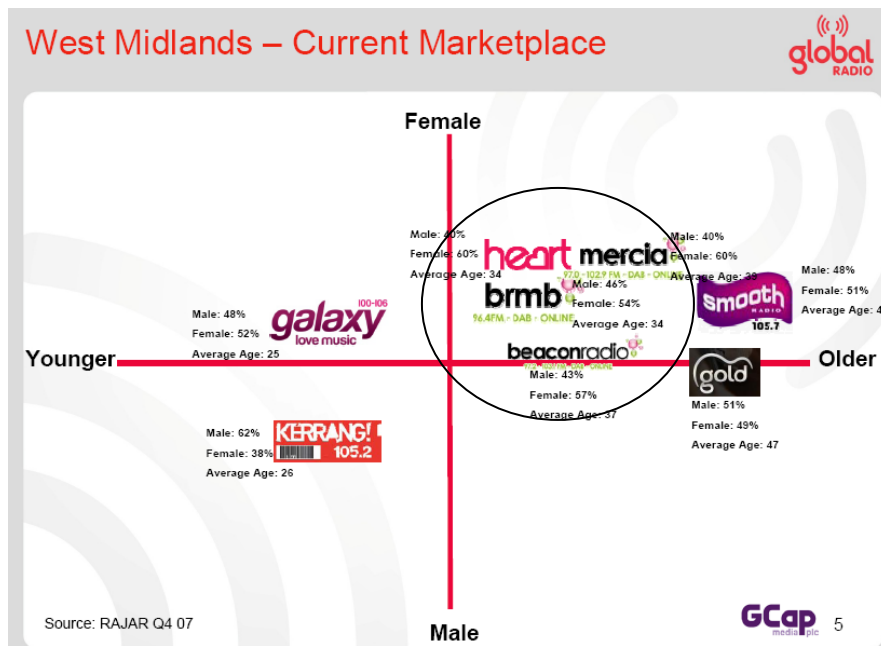
Risk management and error cost in OFT remedies cases

- **Too hot** – remedies overbroad in scope (false conviction)
 - inherent in an asymmetric ‘liability test’ – but internal safeguards (*Dunfermline/BRN*)
 - private costs: give reasonable deference to parties’ calculus (*Celesio v OFT, Global/GCap*)
- **Too cold** – remedies unduly narrow (false acquittal)
 - cautious policy standard: clear-cut remedy to clear-cut concern → divestiture
 - in practice, remedy must meet every (marginal) ‘realistic prospect of harm’
CONCERN (*Celesio v OFT re Boots/UniChem, William Hill/Stanley, Global/GCap, CGL/Somerfield*)
 - couple with procedural safeguards (up-front buyer) (see Alastair’s slides)

Efficiencies

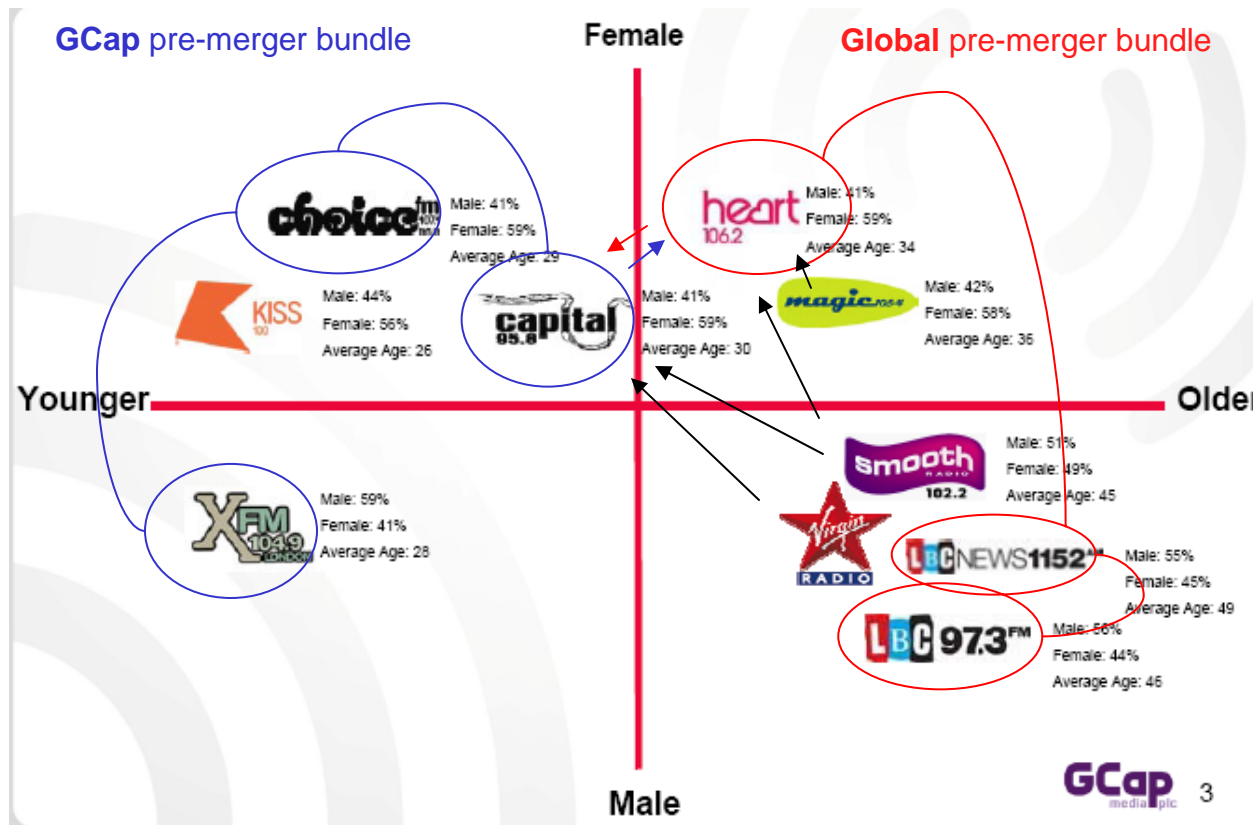
- SLC = lost rivalry; S = customer harm → rivalry (means) link to consumer welfare (end)
- Efficiencies have usual 3-prong test: demonstrable, merger-specific, pass on
- Sliding scale – both for relative size *and* probability
- Should not have to rebut an SLC probability with an efficiencies certainty
- Like non-price harm, unquantifiable or ‘soft’ efficiency claims should not fail simply on this basis. Plus factors: evidence of past mergers/track record, customer support
- Efficiencies defence vs. integrated analysis – OFT gets ‘two bites’
- Only rivalry-enhancing efficiencies can be combined with remedies across different markets at Phase I
- Cf. the customer benefits defence – must trump concerns in all SLC markets, obviating need for remedies

Efficiencies – Midlands commercial radio



Efficiencies – London commercial radio

Avg multi-station discount – [10-20%], up to [30-40%]



46% of listeners

Efficiencies: London vs. the Midlands

| Issue | London | The Midlands |
|---|--|--|
| Anti-competitive effect concern (prior to efficiencies evaluation) | Weak – parties are not close competitors | Strong – parties are 1 st and 2 nd choices for regional radio ad campaigns |
| Cournot effect (merger of complements) | Yes – merger of weak substitutes (complements) for London-wide campaigns | No – merger of close substitutes (for regional campaigns) |
| Product repositioning (indirect network effect) | Some credit given – some repositioning will occur given multiple stations in same geographic market (though products already ‘pushed apart’ (i.e., complementary pre-merger) | Prima facie stronger claims (pushing substitutes apart from a former middle-ground cluster) <u>but</u> complicated in that each Midlands area not a single geographic market like London |
| Variable cost savings | Not claimed | Not claimed |
| Fixed cost savings | Large savings claimed, not demonstrably passed on | Small savings claimed, not demonstrably passed on |



Lloyds/HBOS

- Exceptional – other public interest headings unlikely to be trumps
 - Transparent – competition regime remains independent + credible
 - Democratic – Parliamentary involvement on a genuine public interest question
 - Overall process shows importance attached in the UK to competition policy
 - No protectionist angle
 - No consequences for stringent OFT policy toward failing or flailing firms in markets generally
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