

**RESPONSE TO**

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**Review of Merger Assessment Guidelines**

**A joint publication of the Competition Commission  
and the Office of Fair Trading**

**Draft of 14 April 2010**

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**28 May 2010**



**RESPONSE TO REVIEW OF MERGER ASSESSMENT GUIDELINES  
A JOINT PUBLICATION OF THE COMPETITION COMMISSION AND  
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## 1. INTRODUCTION AND SUMMARY

1.1 Freshfields Bruckhaus Deringer LLP welcomes the opportunity to comment on the “*Review of Merger Assessment Guidelines, a joint publication of the Competition Commission (the CC) and the Office of Fair Trading (the OFT), draft of 14 April 2010*” (the **Draft Guidelines**). As these guidelines are of such central importance to the effective operation of the UK merger control regime, we appreciate the opportunity to comment on them again before they are finalised.

1.1 We recognise that the Draft Guidelines have been significantly revised since the previous draft and that they incorporate many of the comments received during the earlier consultation. In particular, we welcome:

- (a) **Consistency:** the revisions to Sections 1-3, which ensure greater consistency with other guidance issued by the Authorities, particularly on jurisdictional and procedural issues. We believe that it is of paramount importance for all stakeholders engaged in the UK merger regime that legislative guidance is both clear and consistent;
- (b) **Market definition:** the change of emphasis in the role of market definition<sup>1</sup>, and the additional guidance on when supply-side substitution may be relevant in market definition (together with the evidence the Authorities may use in that assessment)<sup>2</sup>;
- (c) **Non-horizontal mergers:** clearer recognition that most non-horizontal mergers are benign or even pro-competitive in their effect, and greater consistency with EU guidelines on non-horizontal mergers<sup>3</sup>; and
- (d) **Presumptions of anti-competitive effects:** removal of the statement that the OFT may presume adverse effects, if it concludes that there is a realistic prospect that the merged firm will have the ability and incentive to engage in input foreclosure following a non-horizontal merger<sup>4</sup>.

1.2 We have limited our comments to those few areas where we have concerns about the revised text, or where we believe that more detail or explanation would help merging parties understand the Authorities’ approaches in certain types of cases. We have avoided repeating comments made in our earlier response, where those comments have not been incorporated, unless we have strong concerns about how the

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<sup>1</sup> Draft Guidelines, paragraph 4.52, and Summary of Respondents’ Submissions, “*The Authorities have redrafted the market definition section to emphasize that market definition continues to be an important element of merger analysis*” (page 13).

<sup>2</sup> Draft Guidelines, paragraphs 4.67-4.68.

<sup>3</sup> Draft Guidelines, paragraph 4.127-4.141.

<sup>4</sup> Merger Assessment Guidelines, draft of April 2009, paragraph 4.145, and Summary of Respondents’ Submissions, “*The Authorities have removed from the revised guidelines the statement that the OFT may presume anti-competitive effects from foreclosure, given ability and incentive*” (page 19).

revised text will impact merger assessments in practice and, therefore, where we believe previous comments are worth re-stating.

## 2. A SUBSTANTIAL LESSENING OF COMPETITION

### What is an “SLC” (adverse effects on rivalry)?

2.1 We have noted the change of emphasis in Section A of Part 4 of the Draft Guidelines which describes what is meant by an SLC, and in particular:

- (a) deletion of the statement that “*the Authorities would not normally find an SLC without an expectation of adverse effects for consumers*”<sup>5</sup>; and
- (b) new text stating that “*it is not an adverse effect on the outcomes of the process of competition (e.g. prices) that differentiates an SLC from a lessening of competition; it is an adverse effect on rivalry. Whether a reduction in rivalry results in an SLC will depend on the extent of the reduction*”<sup>6</sup>.

2.2 Given the practical significance of these statements, we would welcome clarification on whether the revised text is intended to signal a change of approach in the Authorities’ substantive assessment of mergers. We note that:

- (a) both the previous draft guidelines<sup>7</sup> and the original OFT substantive assessment guidance<sup>8</sup> discussed the SLC test in terms of weakening rivalry, but also stated that an SLC is only likely to arise where rivalry is weakened to such an extent that customers/consumers are harmed;
- (b) the European Commission’s guidelines on horizontal mergers discuss merger control in terms of preventing firms increasing their market power to such an extent that they are able “*to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation or otherwise influence the parameters of competition*”<sup>9</sup>; and
- (c) the draft US Horizontal Merger Guidelines discuss how the US Agencies analyse mergers in terms of their impact on customers<sup>10</sup>.

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<sup>5</sup> Merger Assessment Guidelines, draft of April 2009, paragraph 4.5.

<sup>6</sup> Draft Guidelines, paragraph 4.5.

<sup>7</sup> Merger Assessment Guidelines, draft of April 2009, paragraph 4.5.

<sup>8</sup> OFT Mergers Substantive assessment guidance, May 2003: “*A merger may be expected to lead to a substantial lessening of competition when it is expected to weaken rivalry to such an extent that customers would be harmed*” (paragraph 3.7).

<sup>9</sup> Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03), paragraph 8.

<sup>10</sup> Draft US Horizontal Merger Guidelines (20 April 2010): “*Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers*”.

2.3 Against this background, the purpose of the change seems unclear. If this change in the guidance is intended to signal a new approach, it would be important to clarify how the Authorities will determine whether a reduction in rivalry is sufficient to amount to an SLC, rather than simply a lessening of competition, without evidence of harm to customers or of any other adverse outcome.

### **The Counterfactual: the exiting firm scenario**

2.4 We welcome recognition that counterfactuals may include situations where firms exit the market for reasons other than failure<sup>11</sup>. However, we would be grateful for confirmation that our reading of paragraph 4.26 of the Draft Guidelines is correct, in that both the OFT and the CC will accept arguments that a counterfactual could be based on a firm exiting for reasons other than failure.

2.5 If our understanding is correct, it would be helpful to have further details on the types of scenarios (and criteria) that would satisfy the Authorities that the counterfactual should be changed from the pre-merger situation, when one of the merging firms is exiting the market but not failing (with examples, if possible).

2.6 We have also noted two changes to the criteria relevant to satisfying the Authorities that one of the merger firms would have imminently exited from the market had the merger not gone ahead:

- (a) ***Was the firm failing?*** The revised text appears to place less emphasis on the “*inevitability*” of exit, and also takes a more case-specific approach to situations where a profitable parent is closing a loss-making subsidiary. We welcome this change as a recognition on the part of the Authorities that firms may exit a market for reasons other than failure.
- (b) ***Impact on sales of the exiting firm.*** We note the change in language in “*consideration (c)*” from whether exit of the firm would be a “*substantially less anti-competitive outcome than the merger*”<sup>12</sup> to whether exit would be a “*substantially more competitive outcome than the merger*”<sup>13</sup> (having regard to the impact on sales of the exiting firm). We welcome this new wording, but suggest that it would aid clarity and consistency in the application of these tests if this wording was mirrored in consideration (b) (i.e. we suggest that the test should be whether there is a “*substantially more competitive alternative purchaser*”, rather than a “*substantially less anti-competitive alternative purchaser*”).

### **The Counterfactual: Competing bids and parallel transactions**

2.7 In situations where all competing bids are referred to the CC, we note that there are still circumstances when the counterfactual may be changed from the pre-merger situation to an acquisition by another purchaser (who has not yet emerged as a

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<sup>11</sup> Draft Guidelines, paragraph 4.24.

<sup>12</sup> Merger Assessment Guidelines, draft of April 2009, paragraph 4.33.

<sup>13</sup> Draft Guidelines, paragraph 4.27.

bidder) that does not raise competition concerns<sup>14</sup>. It would be helpful if the Draft Guidelines could clarify the circumstances when this situation might happen in practice. For example, is this situation only likely to arise when the target company is exiting the market and, if so, would the CC not apply the standard “exiting firm” criteria to these types of cases? In these types of more unusual circumstance, we suggest that an example (or citation to a previous case) would help parties assess the likelihood of the Authorities taking such an unusual approach in their cases.

2.8 We also note that the Authorities have maintained their approach on parallel transactions<sup>15</sup>, on the basis that a “*first past the post*” system would not be appropriate in the context of the voluntary notification regime. As explained in the Summary of Respondents’ Submissions, the Authorities considered our earlier proposal “*of assessing parallel transactions by reference to the date of a ‘legally binding agreement or public offer’*”. However, they do not believe that either would be entitled to adopt such a prescriptive rule<sup>16</sup>. As the approach taken by the Authorities in these cases could have a significant impact on the outcome of their assessment, we would like to reiterate our concern that:

- (a) the test as to whether or not an anticipated transaction may be taken into account in the assessment of the notified merger is not sufficiently clearly defined in the current Draft Guidelines; and
- (b) this uncertainty opens the way to spoiler tactics by competitors and unnecessary additional deal uncertainty for merging parties. We respectfully submit that this is not an appropriate outcome for the Authorities’ Guidelines.

### 3. MARKET DEFINITION

3.1 As noted above, we welcome the change of emphasis in the Draft Guidelines on the role of market definition in merger analysis, and the role of supply-side substitution in market definition. We have the following comments on some of the other changes to this section:

#### **Hypothetical monopolist/SSNIP: use of variable profit margins**

3.2 We note that the Draft Guidelines now explicitly include “*variable profit margins*” as a relevant factor when evaluating whether a SSNIP by a hypothetical monopolist would be profitable. We recognise that high variable profit margins across a relevant market may indicate that a price rise would be less costly for a hypothetical monopolist. However, we also note that the Authorities intend to use evidence of the variable profit margins of the merger firms alone to make this assessment, rather than the market as a whole<sup>17</sup>. This approach might be seen as

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<sup>14</sup> Draft Guidelines, paragraph 4.43.

<sup>15</sup> “*For the OFT, the question is, as always, whether the transaction under review creates the realistic prospect of an SLC, and it is likely to consider whether the statutory test would be met whether or not the parallel transaction proceeds*” (paragraph 4.45, Draft Guidelines).

<sup>16</sup> Summary of Respondents’ Submissions, page 11.

<sup>17</sup> Draft Guidelines, paragraph 4.65.

conflating two distinct concepts. It would therefore be helpful if the Draft Guidelines could clarify:

- (a) whether the Authorities intend to use evidence of the merger firms' margins as indicative of margins across the market, and if so, how the Authorities would capture the likely existence of widely different margins across a market in their analysis; and
- (b) whether the Authorities intend to infer that high variable profit margins earned by the merger firms alone indicate that a SSNIP by a hypothetical monopolist would be profitable (even though such an assessment might be more relevant to the substantive question of whether the merged firm would have market power, rather than market definition).

3.3 In both cases, it would be helpful if the Authorities could clarify how they will determine whether or not variable profit margins are sufficiently “*high*” in a particular industry or sector to found an inference that a hypothetical monopolist could profitably raise prices.

### **Customer Groups**

3.4 The Draft Guidelines discuss a new “*third dimension*”<sup>18</sup> to market definition: the customer group. We recognise that, where a hypothetical monopolist could profitably target higher prices at a separate customer group, the relevant market might be defined around that group. However, we wonder whether the treatment of this issue in the Draft Guidelines might be clarified.

3.5 In most cases, the existence of a separate group of customers who have different preferences or pay different prices would likely be captured in the assessment of product or geographic market definition since that difference would most likely be a function of product/service differentiation or geographic limitations on delivery. Thus, the draft US Horizontal Merger Guidelines helpfully state that “*in practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers*”, and provide an illustrative example<sup>19</sup>.

3.6 We suggest that it would be helpful if the Draft Guidelines could clarify whether the Authorities anticipate defining relevant markets for separate customer groups only in exceptional cases (e.g. where certain market or product characteristics indicate a particularly high degree of potential price discrimination).

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<sup>18</sup> Draft Guidelines, paragraph 4.53.

<sup>19</sup> Draft US Horizontal Merger Guidelines (20 April 2010): “*Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food*” (section 4.1.4).

#### 4. HORIZONTAL MERGERS – COORDINATED EFFECTS

4.1 We welcome the new text in the Draft Guidelines that the Authorities recognise the difficulties involved in inferring tacit coordination from allegations of cartel behaviour<sup>20</sup>. However, we are still concerned with:

- (a) the principle that suspected cartel actions may indicate that the conditions for coordination are met, given that:
  - (i) firstly, the cartel behaviour may be heavily disputed by the parties involved (who may not even include the merger parties) and the cartel may not eventually be proven; and
  - (ii) secondly, even if it is proven, the cartel behaviour may in fact be evidence that tacit coordination in that market is not possible (as the Draft Guidelines correctly recognise<sup>21</sup>); and
- (b) the prospect of highly confidential and preliminary information being shared with an Authority, and the risk of such information being inappropriately used or disclosed.

4.2 We would be grateful for clarification on how evidence of suspected cartel behaviour may be used, in practice, in merger analysis. For example, how and when is such evidence to be shared with the merging parties to enable them to respond properly to the theory of harm being developed? How do the Authorities deal in practice with situations where there is no clear evidence of cartel behaviour and any allegations of such conduct are heavily disputed by the parties (who may or may not include the merger parties)? In these circumstances, what weight will the Authorities attach to potentially contested evidence?

#### 5. BARRIERS TO ENTRY AND EXPANSION

5.1 We note the change in language as regards the Authorities' assessment on whether or not any entry or expansion would be timely. The previous draft guidelines stated that "*entry or expansion within less than two years will generally be timely*"<sup>22</sup>, whereas the Draft Guidelines now state that the "*Authorities may consider entry or expansion within less than two years as timely*"<sup>23</sup>.

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<sup>20</sup> "*Past proven or suspected cartel actions in the same product market (in the UK or elsewhere) may also indicate that the conditions for coordination were met in that market, although the Authorities recognize that this inference cannot automatically be made*" paragraph 4.110, Draft Guidelines.

<sup>21</sup> "*In markets which are not obvious candidates for tacit coordination according to the conditions in paragraph 4.112, past cartel behaviour may provide positive evidence that tacit coordination is not a real possibility*" Draft Guidelines, paragraph 4.110.

<sup>22</sup> Merger Assessment Guidelines, draft of April 2009, paragraph 4.189.

<sup>23</sup> Draft Guidelines, paragraph 4.170.

5.2 As this apparent change of approach is likely to be highly significant for parties in terms of the evidence they submit during merger assessments, we would be grateful for clarification of the basis for, and anticipated impact of, such a change.

## **6. CONCLUDING REMARKS**

6.1 By way of conclusion, we emphasise that we strongly welcome this second round of consultation on the joint merger assessment guidelines. We believe that the combined guidance will enhance transparency of the UK merger control regime, which will in turn improve consistency and robustness of decision-making.

6.2 If the OFT or CC wish to discuss any of the points made in this response, please contact Simon Priddis (020 7832 7259) or Sarah Jensen (020 7832 7092).

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