

RESPONSE TO

Merger Assessment Guidelines

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

Consultation Document, April 2009

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1. INTRODUCTION AND SUMMARY

1.1 Freshfields Bruckhaus Deringer welcomes the opportunity to comment on the “*Merger Assessment Guidelines, a joint publication of the Competition Commission (the CC) and the Office of Fair Trading (the OFT)*” (the *Draft Guidelines*).

1.2 Our comments are based on our extensive experience of representing clients in merger control reviews throughout Europe, the US and Asia. We believe this experience gives us valuable insight into best practice in merger control internationally.

1.1 We welcome publication of the Draft Guidelines as clearly setting out the OFT’s and the CC’s practice and experience in enforcing UK merger control since the Enterprise Act 2002 (*the Act*) entered into force. Furthermore, we welcome the fact that the Draft Guidelines are a joint initiative between the OFT and CC. All measures that provide greater harmonisation between the OFT’s and CC’s decision-making procedures and methods of assessment are very much appreciated.

1.2 We set out in the following paragraphs our comments on the Draft Guidelines. We have made some general comments on the structure and content of the Draft Guidelines overall and some specific comments on certain sections of the Draft Guidelines. Please note that these comments do not necessarily represent the position of any of our clients.

1.3 We would, in particular, like to highlight the following comments.

- (a) The Draft Guidelines appear to introduce a number of differences in policy and approach to substantive assessment between the CC and OFT on the one hand (together referred to as the *Authorities*) and the European Commission on the other. If the differences are intended it would be helpful if they could be clearly identified as such and reasons for the departure articulated. See paragraphs 2.4 and 2.5 below for more detailed comments.
- (b) Although the Draft Guidelines note differences of approach between the OFT and the CC, the consequences for the parties, in terms of evidence that they are required to produce, is less clear. It would be helpful if detailed guidance could be given of what evidence is required at each of the OFT and CC stages of the substantive analysis. See paragraph 2.6 below for more detailed comments.
- (c) We are concerned that the Draft Guidelines appear in certain respects to reduce the standard of evidence required to satisfy the test for a reference to the CC. In particular we are concerned by the use of presumptions that appear to reverse the burden of proof. See paragraphs 2.8 to 2.10 below for more detailed comments.
- (d) We are concerned that the proposal to move away from a first past the post principle to assessing parallel transactions may encourage unmeritorious tactics by competitors and would create significant additional uncertainty for the merging parties. We recommend a first past the post approach to assessing

parallel transactions based upon when a legally binding agreement is concluded or public offer announced. See paragraphs 3.2 to 3.5 for more detailed comments.

- (e) The Draft Guidelines appear to suggest that in differentiated product markets the Authorities will focus upon closeness of competition to assess competitive constraints. It would be helpful if further guidance could be published on when these techniques are appropriate and what evidence the parties will need to adduce, at each of the OFT and CC stages of the analysis. See paragraphs 3.22 to 3.25 for more detailed comments.

2. GENERAL COMMENTS

Combined guidance: avoiding duplication and inconsistency

2.1 We welcome the joint initiative by the OFT and the CC in publishing the Draft Guidelines. Consolidating advice in a single document and reducing the potential for conflicting guidance is of great practical benefit.

2.2 However, we are concerned about the risk of confusion and inconsistency from the areas of overlap between various guidance published by the Authorities. In particular, the Draft Guidelines summarise advice given in the OFT’s “Mergers – jurisdictional and procedural guidance” (*OFT J&P Guidance*), but omit the detail that is critical to understanding how these principles are applied in practice¹. This may cause confusion in practice as regards the relative weight given to each guidance and any differences in approach at the CC. There are also a few areas of apparent inconsistency between the Draft Guidelines and the OFT J&P Guidance (which we have listed in an Annex to this response).

2.3 We suggest that, in order to avoid the risk of inconsistency, the Draft Guidelines could incorporate (by reference) the more detailed guidance on jurisdiction and procedure contained in the OFT J&P Guidance, and explain more fully any differences in approach at the CC. The remainder of the Draft Guidelines could then deal exclusively with substantive issues.

Differences in policy between the UK Authorities and the European Commission

2.4 The Draft Guidelines appear to introduce a number of differences in policy and approach to substantive assessment between the UK Authorities and the European Commission. The apparent differences occur primarily in the treatment of market definition and non-horizontal mergers:

- **market definition:** the Draft Guidelines appear to downplay the role of supply-side substitution in defining markets (see paragraphs 3.14 and 3.15 below) and

¹ For example: the OFT J&P Guidance describes in detail the factors taken into account in determining “material influence” including the presumptions that arise when a shareholding confers on the holder more than 25% of voting rights, and the circumstances in which the OFT will examine holdings of 15% or more, or exceptionally less than 15%. The Draft Guidelines provide a summary of the high-level principles but omit these key practical guidelines.

the level of “safe harbour” afforded by HHI thresholds (see paragraph 3.20 below);

- ***non-horizontal mergers:*** the Draft Guidelines appear to depart in several areas from the recently published European Commission guidelines, specifically on the conditions required (and factors taken into account) when demonstrating anticompetitive effects in vertical and conglomerate mergers (see paragraphs 3.37 to 3.55 below).

2.5 If these differences in approach are intended, we suggest that they are identified as such, and the reasons for the departures clearly articulated. Clear signposting and explanation is essential, particularly for the many non-UK companies and advisers involved in UK merger control (who will be familiar with the European Commission’s approach on issues of substance and may expect significant differences in the UK to be limited to issues of jurisdiction and procedure). We are also concerned that apparent differences in substantive approach may encourage undesirable “forum shopping” by merging parties (particularly given the mechanisms for parties to request referrals of cases between jurisdictions, if certain conditions are met).

Differences in procedure and approach between the OFT and CC

2.6 One of the possible benefits of producing joint guidance is the ability to set out clearly for merging parties the differences in the evidence that will be required by the OFT and the CC to conduct their substantive assessments. Although differences in approach between the OFT and CC are noted in the Draft Guidelines² the consequence for the parties, in terms of evidence that they are required to produce, is less clear. It would be helpful if detailed guidance could be given as to the evidence required at each of the OFT and CC stages of the substantive analysis.

New policies: practical guidance and case references

2.7 The Draft Guidelines make a number of material changes to previous practice and guidance published by the Authorities³. Some of these changes were helpfully brought to our attention at the seminar held by the OFT and CC on 1 June 2009 and in our meeting on 22 July 2009. However, we are concerned that the potential significance of these changes is not widely understood. It would be helpful, particularly for companies and advisors who are not so familiar with UK merger control in practice, if the Draft Guidelines specifically highlighted changes in policy and contained more practical examples and case references on the less developed theories of harm.

² For example: (i) differences in approach to the counterfactual; and (ii) presumptions of anticompetitive effect at the OFT stage of analysis.

³ For example: (i) new approaches to the counterfactual (parallel transactions and competing bids); (ii) the assessment of unilateral effects in differentiated product markets (the role of market definition and closeness of competition analyses); and (iii) diagonal mergers (as a new category for assessment).

OFT's duty to refer and burden of proof

2.8 Although the Authorities acknowledge that the test for reference is that of a realistic prospect of a substantial lessening of competition (an *SLC*), we are concerned that (in a number of places) the Draft Guidelines appear to allow the OFT to presume an SLC once certain thresholds have been crossed.

2.9 For example, presumptions appear to be raised when an ability and incentive to foreclose has been demonstrated in non-horizontal mergers without having to show any likelihood of anticompetitive effect. Presumptions are also raised by the OFT, in practice, of unilateral effects on the basis of relatively new and untested models of closeness of competition. We believe that caution should be exercised when raising such presumptions in establishing a duty to refer, within the meaning of the legislation and the Court of Appeal's interpretation of the standard for reference.

2.10 Furthermore, the Draft Guidelines state, at paragraph 2.5, that "*the greater the cost of error of reaching the wrong decision, the more likely it is that the OFT will conclude that the test for a reference is met.*" The implication of this statement appears to be to reduce the threshold for a reference because a merger occurs in a large market. This would seem inconsistent with the OFT's duty to find a realistic prospect of an SLC and further clarification would be welcome.

3. A SUBSTANTIAL LESSENING OF COMPETITION (PART 4)

The Counterfactual

3.1 As highlighted in paragraph 2.7 above the Draft Guidelines appear to make a number of changes to previous practice and guidance published by the Authorities. One of the areas in which there appear to be material changes is in the approach of the Authorities to determining the counterfactual.

Paras 4.40 - 4.42 ***Parallel transactions***

3.2 The OFT's draft jurisdictional and procedural guidance (March 2008) stated that the OFT would apply a "first past the post" principle to assessing parallel transactions⁴. This approach has the advantage of certainty for the parties and encourages early notification. It is also consistent with general European Commission practice.

3.3 In contrast, the Draft Guidelines state that the OFT "*is likely to consider whether the statutory test would be met whether or not the parallel transaction proceeds (unless one of the transactions can clearly be ruled out as too speculative)*" (paragraph 4.41) and for the CC "*the relevant counterfactual will depend on whether it expects that parallel transaction to proceed*" (paragraph 4.42). We are concerned that this change in policy could encourage unmeritorious tactics by competitors and

⁴ "*If two parallel transactions in the same industry are notified, only one of which would create competition concerns and that conclusion depends on the sequence in which the bids are considered, the transaction for which the OFT first receives a satisfactory submission will be considered first in time*" (paragraph 4.80).

would create significant additional uncertainty for merging parties. It would also deny merging firms a legitimate commercial first mover advantage and may create incentives for “forum shopping” between jurisdictions.

3.4 Our recommendation is that the criteria is not notification but the conclusion of a legally binding agreement or public offer. In the interests of certainty we suggest that this would occur when a legally binding agreement is signed or a public announcement is made of a firm intention to make an offer or of a possible offer (corresponding with Rules 2.5 and 2.4 of the Takeover Code respectively). We believe such an approach avoids the problem of comparing notified and non-notified transactions and leaves the incentive to notify (i.e. to obtain pre-transaction certainty) unaffected. It also allows firms that progress to a binding agreement quickly to benefit from a first mover advantage whilst minimising the opportunity for unmeritorious spoiler tactics.

3.5 However, if the Authorities intend to depart from the “first past the post principle”, then we suggest that the reasons for this change in policy are clearly explained and the basis on which the OFT would decide whether or not a parallel transaction is “*too speculative*” are described in detail.

Paras 4.27-4.33

Failing firms

3.6 We welcome the joint guidance on the “failing firm” defence and the more harmonised approach of the Authorities as regards the criteria used in this assessment.

3.7 We would, however, welcome further guidance on how the OFT will assess the counterfactual, in circumstances where it has determined that a firm is failing but that there is a substantially less anti-competitive alternative buyer. The Draft Guidelines state that “*the OFT, as a Phase 1 body, will not adopt a counterfactual based on an alternative buyer*” (paragraph 4.31). This would seem at odds with the approach currently proposed for assessing parallel transactions in which the OFT will “*consider whether the statutory test would be met whether or not the parallel transaction proceeds (unless one of the transactions can clearly be ruled out as too speculative)*” (paragraph 4.41).

Paras 4.34-4.39

Competing bids

3.8 The previous practice of the Authorities has been to assess competing bids on their own merits without reference to the likelihood of an alternative bid succeeding. In contrast, the Draft Guidelines state “*Where all the bids are referred, the counterfactual will generally be the pre-merger situation, although the authorities will consider the appropriateness of the counterfactual being another bid that does not raise prima facie competition concerns*” (paragraph 4.39).

3.9 It is not clear to us when it would ever be appropriate for the Authorities to take into account a competing bid in determining the counterfactual⁵. To do so in cases where the competing bid “*does not raise prima facie competition concerns*”

⁵ Other than possibly in failing firm situations when the prevailing conditions of competition will not continue in any event.

would introduce significant uncertainty for parties attempting to assess the Authorities' evaluation of an alternative transaction. It also seems inappropriate, particularly in a public bid context, for the Authorities to take a view on an alternative transaction when shareholders have yet to express a preference. If this change in approach is intended, we suggest that the Takeover Panel's views should also be solicited.

3.10 We also suggest that the Authorities should specify whether this section of the Draft Guidelines is limited to public bids or whether "bid" is used in a more general sense of a competing transaction.

Market definition

3.11 We understand that the Draft Guidelines reflect a policy of the Authorities to place less emphasis on market definition as a framework for identifying competitive constraints and greater emphasis on alternative theories, such as closeness of competition. We recognise that market definition does have its limitations and that closeness of competition can be a useful tool in merger analysis. However, we would caution moving too far from market definition as an analytical tool.

3.12 Market definition has proved over many years to be a very useful screen for the Authorities and the merging parties to identify transactions that prima facie do not raise competition concerns. It can help minimise the cost and burden, for the parties and the OFT, in assessing which transactions justify an in-depth analysis by the CC. In contrast, assessing closeness of competition generally requires the parties to produce information that is not readily available, it remains unclear what evidence each of the Authorities would find convincing and the assessment significantly increases the costs, complexity and uncertainty of merger analysis.

3.13 We set out in the following paragraphs a few specific areas in which reduced emphasis on market definition, where it could be appropriately used, potentially increases uncertainty for merging firms. We also highlight some areas in which it may be helpful to provide additional guidance on the closeness of competition analysis (if not in this guidance then in a separate discussion paper).

Para 4.50

Demand-side and supply-side substitution

3.14 In appropriate circumstances, supply-side substitution plays an important role in market definition. The European Commission recognises that "*supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy*"⁶. Similarly the OFT states in current guidance that "*in some cases, where there are high levels of supply side substitutability, it may be appropriate to define a market with reference to the similarity of production methods.*"⁷

⁶ Commission Notice on the definition of relevant market for the purposes of Community competition law (OJ C 372, 09/12/1997), paragraph 20.

⁷ OFT 403, Market definition: understanding competition law (paragraphs 3.17-3.18).

3.15 We understand that the intention of the Authorities is to define markets “*by reference to demand-side substitution alone*” (paragraph 4.50) and to use supply side substitution to determine who the competitors are in the market. This is a significant departure from earlier guidelines and those of the European Commission and it would be helpful if it could be highlighted as such. We would also appreciate it if reasons could be provided for the departure in the Draft Guidance.

Para 4.62 – 4.63 ***Assessing demand-side substitution***

3.16 In paragraph 4.62 the Draft Guidelines helpfully set out the type of evidence that the Authorities would find useful in assessing demand-side substitution. Some of this evidence, such as econometric studies, would need to be specifically produced by the merging parties for the purposes of the merger assessment. In paragraph 4.63 the Draft Guidelines state that this evidence may then be supplemented by other calculations, such as critical loss and critical elasticity. These are not calculations that are ordinarily undertaken by many businesses. Given that the merging parties will need to commission much of this evidence it would be helpful if the Draft Guidelines could indicate which evidence the Authorities will expect to be produced at the OFT stage of the analysis and which at the CC stage of the analysis.

3.17 In describing the type of profit margin data that the Authorities would find useful the Draft Guidelines state that there is an inverse relationship between a firm’s price-cost margin and the elasticity of demand and that “*the Authorities will expect estimates of both to be consistent with each other*” (footnote 48). The inverse relationship between margins and elasticity of demand (otherwise known as the Lerner Index) does not however hold true for all industries, which suggests that the underlying principles and analysis of the evidence would benefit from additional clarification.

Para 4.55 & 4.67 ***SSNIP***

3.18 In applying the SSNIP test to determine market definition the Draft Guidelines state that “*the Authorities will normally apply a price increase of 5 per cent*” but that the “*guiding principle is that the price increase applied should be one that is judged small but significant in the particular market under consideration*” (paragraph 4.55). We note that the approach suggested would appear to depart from a widely understood benchmark of applying a 5 – 10% price rise⁸ and would introduce a significant degree of uncertainty for merging parties and advisers. If the Authorities intend to apply a price rise that varies depending upon the market under consideration then we would welcome detailed guidance on what the appropriate figure is for each market in which a 5 – 10% price rise will not be applied.

3.19 In assessing a merger with multiple geographic markets the Authorities appear to move away from the SSNIP test altogether. Paragraph 4.67 of the Draft Guidelines state that “*the Authorities may examine the geographic catchment area within which the great majority (usually 80 per cent or more) of the retailers’ custom is located.*”

⁸ We note that the ICN Merger Guidelines Workbook states that the “*common benchmark used is between 5 and 10 per cent.*”

We would welcome further explanation of why each of the Authorities chooses to abandon the SNNIP test in these circumstances and why an 80 per cent figure is an appropriate rule of thumb.

Paras 4.84 – 4.93 ***Measures of concentration***

3.20 We recognise the limitations of HHI thresholds in assessing competitive constraints. However, we suggest that if these thresholds are to be included, the wording should reflect that of the European Commission and provide more of a “safe-harbour” for merging firms. Although the same HHI thresholds are used by the Commission and the UK Authorities, the Commission states that it “*is unlikely to identify horizontal competition concerns in a merger*” below the thresholds, whereas the Draft Guidelines state that the UK Authorities “*may have regard to*” the thresholds (paragraph 4.93). Is this different wording intended to have significant implications in practice? If not, it would be preferable for it to be conformed to the European Commission test. If a substantive difference is anticipated, this could usefully be clarified.

Paras 4.75 & 4.83 ***Direct evidence of competitive constraints***

3.21 The Draft Guidelines appear to suggest that, in markets where prices are set by bilateral negotiation and in markets where competition takes place through R&D, the Authorities are likely to focus less on market definition and more upon direct evidence of competitive constraints. If that is the intention then we would find it helpful if the Draft Guidelines could set out how the Authorities will directly assess competitive constraints and what evidence each of the Authorities would find useful for such an assessment.

Paras 4.102 – 4.104 ***Closeness of competition***

3.22 The Draft Guidelines appear to suggest that in differentiated product markets the Authorities will focus upon closeness of competition to assess competitive constraints. We are concerned that the techniques for assessing closeness of competition are not widely understood and that companies will be unable to address the issues without access to highly specialised economic and legal advice.

3.23 It would be helpful if the guidance recognised that these complex techniques are not appropriate in all circumstances. It would also be helpful if further, perhaps separate, guidance could be published for consultation on when these techniques are appropriate and what evidence the parties will need to produce, at the OFT and CC stages of the analysis, to satisfy a closeness of competition test.

3.24 In particular, guidance on the thresholds above which closeness of competition is considered to be a concern would be welcome. We are concerned that the illustrative price rise model used by the OFT will always predict a price rise as a result of a merger and that the model appears to be highly sensitive to underlying assumptions (including the demand curve faced by the merging firms and the manner in which profit margins are calculated). Clear guidance on the thresholds at which prima facie competition concerns are raised is therefore critical.

3.25 Likewise, clear guidance on the evidence that parties are required to produce, at each stage of the analysis, to allow the Authorities to undertake a closeness of competition analysis and to rebut any resulting presumption would also be very welcome. Often parties will not have readily available information required by the Authorities to produce diversion ratios and appropriate gross margins. The evidence that is used is also subject to critical limitations⁹. For example, the CC appears, in recent cases, to have been sceptical about the reliability of using consumer surveys to calculate diversion ratios when the products at issue constitute only a small amount of consumer spend with the merging party and where consumers might not be spontaneously aware of the options available. Guidance on such issues would therefore be positively received.

Concurrent theories of harm

Paras 4.14

3.26 At paragraph 4.14 the Draft Guidelines state: “*Where several concurrent theories of harm might arise, each of which may not individually constitute an SLC, the Authorities will make an overall assessment of whether or not the relevant SLC threshold is met.*” It is not clear that such an assessment would meet the statutory test for a reference or for finding an SLC.

3.27 If the OFT does not believe that any of the theories of harm are “more than fanciful” or otherwise meet the test for a reference it is difficult to see how the OFT can be convinced that there is a “realistic prospect” of an SLC. It is even harder to understand how the CC can find that the merger “has resulted or may be expected to result” in an SLC if the CC is not convinced that any of the theories of harm are more likely than not to occur. We would welcome practical examples of when the Authorities will use an overall assessment of concurrent theories of harm to come to a different conclusion than they would if they assessed of each of the theories individually.

Co-ordinated Effects: evidence of pre-existing coordination

3.28 We understand that the Authorities will take evidence of pre-merger coordination into account in deciding whether a merger makes coordination more sustainable or more effective. We have concerns about both the evidence that would be used to show pre-merger coordination and the conclusions that would be drawn from such evidence.

Para 4.120 &
4.126 – 4.128

Pricing and market share evidence

3.29 In paragraph 4.120 the Draft Guidelines state that “*market outcomes pre-merger such as pricing and market share may be hard to reconcile with non-coordinated behaviour*”. We wish to emphasise that the Authorities must be able clearly to demonstrate that pricing and market share information is evidence of

⁹ We note that the anticipated acquisition by HMV Group Plc of Ottakar’s plc and the completed acquisition by Game Group Plc of Gamestation Ltd were both referred by the OFT to the CC partly on the basis of a closeness of competition analysis and were both subsequently cleared by the CC on the basis that other retailers would continue to exert a competitive constraint on the merged entity.

coordinated behaviour, rather than strong and effective competition. As mentioned in the current CC guidelines on merger references, “*identifying coordinated effects is difficult. Whilst intense competition generally results in similar or identical prices, so too do coordinated effects. Therefore, the observation that prices are similar, and even that they tend to move together does not of itself demonstrate oligopolistic pricing of the type described above*”¹⁰. To show pre-existing coordination the Authorities must find strong evidence that the conditions set out in paragraph 4.118 of the Draft Guidelines are satisfied pre-merger.

3.30 We would also find it helpful if the description of the first condition for establishing co-ordination, ability to reach and monitor the terms of coordination, specified that the condition needs to hold true at two points in time. First the market conditions need to be such, as described in paragraphs 4.126 to 4.128 of the Draft Guidelines, to allow the competitors to reach terms of coordination. However, once a competitor has deviated from the terms of coordination and has been punished, as described in paragraphs 4.129 to 4.130 of the Draft Guidelines, there needs to be a mechanism to allow the competitors to once again reach terms of coordination. The coordinated price, for example, may not be immediately obvious if prices during the punishment phase have been cut to competitive or below competitive levels.

Para 4.120

Cartel proceedings

3.31 Only past cartel infringement decisions that have been finally determined should be taken into account in assessing whether there is pre-merger coordination (even then extreme care should be taken as it is not clear that a finding of overt cartel behaviour necessarily establishes that tacit coordination is more likely to occur)¹¹. Preliminary actions, interim proceedings and cases on appeal should be excluded on the basis that ultimately there may or may not be sufficient grounds for the Authorities or courts to make an infringement finding. Otherwise, the Authorities risk undermining the basic jurisprudential presumption of innocence until guilt is proven.

3.32 Furthermore we would be concerned if confidential evidence from separate cartel proceedings was to be used in merger proceedings. We would also be concerned if the Authorities in merger proceedings were to rely on evidence in cartel proceedings in which the merging parties are not involved and have no visibility.

Para 4.121

Presumption that mergers increase coordination

3.33 We are concerned that there is a trend towards reversing the burden of proof for showing coordination. Although it is true that, in circumstances where there is pre-merger coordination, a further concentration of the market may make coordination easier to sustain, it is also the case that further concentration will have no effect if the market conditions are such that coordination is already highly effective. We therefore question whether there should be a presumption, in circumstances where pre-merger coordination is proved, that the merger will make coordination more likely.

¹⁰ Merger references, Competition Commission Guidelines, paragraph 3.43, June 2003.

¹¹ The European Commission in ABF/GBI (Comp/M.4980) refers only to “past cartel decisions”.

Furthermore, we disagree that such a presumption can only be rebutted by showing that the merger removes the incentive to coordinate.

3.34 In its investigation of the acquisition by *Napier Brown Foods Plc of James Budgett Sugars Ltd*¹² the CC considered evidence of awareness of competitor behaviour, incentives to conform to the prevailing behaviour and weak competitive constraints, to establish pre-merger coordination. Analysis by the CC was not limited to observations on “*pricing and market share*”. The CC then went on to consider whether the merger would make coordination significantly more sustainable or effective. Its analysis was not limited to determining whether the “*structure and scale of the merged firm is so different from its predecessors’ that the incentive to coordinate has been removed.*” The CC found that the merger would not make coordination more sustainable or effective on the basis that it expected the merger:

- (a) to have little or no impact on the general structure of supply;
- (b) would not significantly alter the constraints on aggressive price cutting by the merged company, the ability of sellers to adjust prices quickly and customers to respond; and
- (c) would not significantly affect the lack of potential for entry, the ineffectiveness of non-coordinating firms or lack of countervailing buyer power.

3.35 The CC therefore found a lack of coordinated effects, not on the basis that the merger would destabilise pre-merger coordination, but on the basis that the merger did not alter the pre-merger awareness of competitor behaviour, incentives to conform and lack of competitive constraints.

3.36 We therefore recommend that the Draft Guidelines place a greater emphasis on the evidence required to show, both pre-merger and post-merger, that the three conditions for coordination are satisfied. We also recommend removing the presumption that a merger is likely to make existing coordination more sustainable or effective.

Non-horizontal mergers

3.37 We welcome combined guidance on the potentially anti-competitive and pro-competitive effects of vertical mergers. In particular, we welcome:

- (a) the Authorities’ focus on the economic effects of these mergers and the clear recognition that, in line with current thinking, vertical mergers are “*less likely to lead to anti-competitive effects*” and often provide “*substantial scope for efficiencies*” (paragraph 4.135); and
- (b) we welcome the framework set out in the Draft Guidelines, which follows the approach of the European Commission in its “*Guidelines on the assessment of*

¹² 15 March 2005

non-horizontal mergers under Council Regulation on the control of concentrations between undertakings” (the EC Non-horizontal Guidelines).

3.38 However, we have a number of comments on potential inconsistencies between the Draft Guidelines and the EC Non-horizontal Guidelines. We suggest that, if differences in policy and approach between the European Commission and the UK Authorities do remain, it would be helpful if they could be clarified.

Paras 4.140 –
4.141

Input foreclosure: Significant market power upstream

3.39 The Draft Guidelines state that input foreclosure arises when “*the merged firm with market power raises the costs of its non-vertically-integrated downstream rivals*” (paragraph 4.137), that input foreclosure is “*more likely where the merged firm has significant market power upstream*” (paragraph 4.141) and that “*an upstream market share of less than 30 per cent will not often raise concern over market power in relation to anti-competitive input foreclosure*” (paragraph 4.141). However, the Draft Guidelines also state that “*anti-competitive effects of input foreclosure can arise when the merged firm does not have upstream market power*” (footnote 87).

3.40 The EC Non-horizontal Guidelines are much clearer in stating that “*non-horizontal mergers pose no threat to effective competition unless the merged entity has a significant degree of market power*” (paragraph 23) and “*for input foreclosure to be a concern, the vertically integrated firm resulting from the merger must have a significant degree of market power in the upstream market*” (paragraph 35).

3.41 We suggest that the Draft Guidelines clarify whether or not the UK Authorities take a wider approach to an ability to foreclose access to inputs than the European Commission, and the reasons for any differences in approach should be clearly stated.

Paras 4.144 –
4.145

Input foreclosure: effect on competition

3.42 It is clear from both the Draft Guidelines and the EC Non-horizontal Guidelines that, even where the merged firm has the ability and incentive to foreclose access to inputs or customers, the overall likely impact on competition will depend on a number of factors, including:

- (a) whether the foreclosed firms play a sufficiently important role in the competitive process on the downstream market;
- (b) whether a sufficiently large fraction of upstream output is affected by the revenue decreases resulting from the merger in the case of customer foreclosure;
- (c) the likelihood of entry, both upstream and downstream;
- (d) the presence of buyer power; and
- (e) the likelihood of efficiencies which may outweigh the adverse effects on competition.

3.43 We are therefore concerned by the statements in the Draft Guidelines that if the OFT “concludes that there is a realistic prospect that the merged firm will have the ability and incentive to engage in input foreclosure, it may presume that such foreclosure will also have an adverse effect” (paragraph 4.145) and “the OFT may presume that sufficient ability and incentive on the part of the merged firm will lead to adverse effects” (paragraph 4.150).

3.44 The Act requires the OFT to establish a belief, before making a reference, that it is or may be the case that a relevant merger situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK. The Act does not state that the prospect of an SLC can be assumed once the merged entity is shown to have the ability and incentive to lessen competition. The Court of Appeal in IBA Health held that the standard required to establish whether the test for a reference is met is that there is “a realistic prospect” of an SLC. We do not consider an ability and incentive to foreclose to amount to a realistic prospect of an SLC without an investigation into the likely impact on competition, if that is the intention.

3.45 We have similar concerns with the statement made regarding conglomerate mergers that “if the merged firm is found likely to have the ability and incentive to foreclose, the OFT may assume that such foreclosure will have anticompetitive effects” (paragraph 4.165).

Paras 4.144 –
4.145

Input foreclosure and the scale of downstream presence

3.46 The UK Authorities and the European Commission have recognised that for input foreclosure to have a substantial or significant adverse effect upon competition, the firms foreclosed must have a significant presence on the downstream market. The Draft Guidelines refer to “the nature of competition upstream and downstream” in assessing the likely effects of any input-foreclosing strategies on competition (paragraph 4.144). The EC Non-horizontal Guidelines state “Significant harm to effective competition normally requires that the foreclosed firms play a sufficiently important role in the competitive process on the downstream market” (paragraph 48).

3.47 It would be helpful if there was guidance on what constitutes a sufficiently important role downstream for these purposes. Would it be possible to suggest a market share threshold to give merging parties an indication of what, absent exceptional circumstances, does not raise competition concerns?

Para 4.170

Effect of foreclosure on the number of competitors

3.48 The Draft Guidelines state that “a vertical merger that results in foreclosure will reduce the number of players in the market...” (paragraph 4.170). However the Draft Guidelines in paragraphs 4.142 and 4.147 acknowledge that there is a difference between what is described as “partial foreclosure” which results in higher costs and “total foreclosure” which results in firms exiting the market. The EC Non-Horizontal Guidelines states that the term “foreclosure will be used to describe any instance where actual or potential rivals’ access to supplies or markets is hampered or eliminated as a result of the merger” (paragraph 16).

3.49 We therefore recommend stating, in paragraph 4.170, that foreclosure “*could reduce*” rather than “*will reduce*” the number of players in the market.

Paras 4.159-
4.161

Conglomerate mergers

3.50 The EC Non-horizontal Guidelines state, in the context of assessing tying and bundling, that “*In order to be able to foreclose competitors, the new entity must have a significant degree of market power, which does not necessarily amount to dominance, in one of the markets concerned*” (paragraph 99) and “*Further, for foreclosure to be a potential concern it must be the case that there is a large common pool of customers for the individual products concerned*” (paragraph 100).

3.51 The Draft Guidelines do not make market power or a common pool of customers prerequisites to establishing a tying or bundling concern arising from a conglomerate merger. The Draft Guidelines state only that foreclosure “*will generally be more likely*” if the merged firm has significant market power in at least one of the markets involved or there is a large pool of shared customers for the products.

3.52 It would be helpful if the Draft Guidelines could clarify whether the UK Authorities take a narrower view than the European Commission about the criteria required to establish that the merged entity has the ability to foreclose through tying and bundling and if so why.

3.53 It would also be helpful if the Draft Guidelines could clarify whether a merger between parties that produce products that are imperfect substitutes would be assessed as a conglomerate merger and if so whether the merger will be assessed differently to a conglomerate merger where the products are complements.

Paras 4.156-
4.161

Portfolio effects

3.54 The EC Non-horizontal Guidelines recognise the customer benefits that may arise from a merged firm being able to offer a portfolio of products¹³ and clearly state that competition concerns from such effects are unlikely to arise¹⁴. However, the Draft Guidelines take a more restrictive approach (paragraphs 4.156 and 4.160-4.161). It would be helpful, if intended, that the reasons for any differences in policy are clearly explained.

Para 4.168

Diagonal mergers

3.55 It is not clear to us why such mergers should be treated as a special category as the example given would appear to arise in rare circumstances. If this separate category is to be retained, we suggest that practical examples and case references would significantly help in understanding when these concerns arise in practice.

¹³ “*Similarly, mergers which involve products belonging to a range or portfolio of products that are generally sold to the same set of customers (be they complementary or not) may give rise to customer benefits such as one-stop-shopping*” (para 14).

¹⁴ “*The fact that the merged entity will have a broad range or portfolio of products does not, as such, raise competition concerns*” (para 104).

Barriers to entry: assessing likelihood of entry

Para 4.187

3.56 As acknowledged in the Draft Guidelines the likelihood of new entry is relevant to the competition assessment because the new competitor may enter to defeat the consumer detriment that would otherwise arise from the merger. In particular the assessment is whether a new competitor is likely to enter the market to defeat a hypothetical price rise by the merged entity.

3.57 However, the Draft Guidelines state that: “*In assessing the likelihood of post-merger entry, the Authorities will evaluate whether entry is likely to take place at pre-merger prices*” (paragraph 4.187). We believe that, in assessing whether entry is likely, that likelihood should be assessed at the hypothetical post-merger price levels rather than the pre-merger level.

3.58 The question of whether entry is likely will depend upon numerous factors, including whether the entrant is likely in the longer term to be successful at pre-merger prices so as to recoup capital investment required to enter. However, it would be wrong to start the assessment at pre-merger prices because in the interim, before prices fall to pre-merger levels, the entrant may, for example, have reduced costs, captured market share, established a brand or developed a distribution network that would justify continued participation in the market. In *Stonegate Farmers/Deans Food Group*¹⁵ and *Long Clawson Dairy / Millway*¹⁶, for example, the CC found that some retailers would sponsor entry if prices were to rise. The price rise has a material impact upon the likelihood of entry.

3.59 We therefore recommend that pre-merger prices are not used as the starting point for assessing the likelihood of entry.

Efficiencies

Paras 4.200 –
4.220

3.60 We very much welcome the greater weight placed by the Authorities in the Draft Guidelines on the role that efficiencies play in merger assessment. In particular we welcome the additional guidance provided on the types of efficiencies that the Authorities may take into account in analysing the effects of the merger.

3.61 However, we are less clear and would appreciate guidance on which of these efficiencies will be taken into account at what stage of the assessment. As is acknowledged in paragraph 4.201 of the Draft Guidelines, efficiencies are relevant at two stages of the assessment: “*First, efficiencies may be taken into account where they benefit customers and prevent a merger giving rise to an SLC. Second, efficiencies may also be taken into account where they do not prevent an SLC but nonetheless outweigh it to the benefit of customers.*” The Draft Guidelines provide no guidance for merging parties on which efficiencies are relevant to which stage or whether the same efficiencies can be argued at both stages of the analysis.

¹⁵ 20 April 2007, paragraph 6.57

¹⁶ 14 January 2009, paragraph 5.27

3.62 In fact the Draft Guidelines appear to suggest that only efficiencies that prevent the SLC, rather than give rise to customer benefits that outweigh the SLC, will be considered. At paragraph 4.204 the Draft Guidelines state “*Efficiencies must be demonstrated to be very likely to arise, and to do so within a period of time corresponding to the onset of any potential adverse effects on customers.*” This would appear to leave no room for dynamic efficiencies that may take longer to realise, that may not prevent the SLC from arising but that may ultimately outweigh the adverse effects of the SLC. We would appreciate any clarification.

4. CONCLUDING REMARKS

4.1 By way of conclusion, we emphasise that we strongly welcome the publication of joint merger assessment guidelines. We believe that up-to-date and combined guidance enhances transparency of the UK merger control regime, which in turn improves consistency and robustness of decision-making.



FRESHFIELDS BRUCKHAUS DERINGER

7 August 2009

ANNEX
Areas of Inconsistency between the OFT J&P Guidance and the Draft Guidelines

Issue	Draft Guidelines (OFT & CC)	OFT J&P Guidance
Effect of not notifying	<p><i>“UK merger control law does not require that a qualifying merger be notified to the OFT. However, companies can seek legal certainty by informing the OFT about a prospective merger in advance so as to obtain clearance (and the OFT encourages companies to contact it early in the merger process)” (para 1.9).</i></p>	<p><i>“it is perfectly acceptable not to notify a merger ... and the fact that a merger has not been notified does not negatively affect the OFT’s substantive assessment” (para 4.2).</i></p>
Meaning of enterprise	<p><i>“However, there is no requirement that the transferred activities should be <u>currently</u> profitable, or generating a dividend for shareholders, and transferred activities conducted on a not-for-profit basis are caught by the definition” (para 3.6).</i></p>	<p><i>“However, there is no requirement that the transferred activities generate a profit or dividend for shareholders: indeed, the transferred activities may be loss making or conducted on a not-for-profit basis” (para 3.8).</i></p>
	<p><i>“The business acquired may no longer be trading but this does not in itself prevent the business from being an enterprise for the purposes of the Act” (para 3.8).</i></p>	<p>The OFT provides more detailed guidance on the factors generally applicable where a business is not trading at the time of the merger (paras 3.11-3.12).</p>
Control	<p><i>“Section 26(3) of the Act provides the Authorities with a discretion (rather than an obligation) to treat material influence and de facto control as equivalent to legal control” (para 3.10).</i></p>	<p><i>“Section 26(3) of the Act provides that the OFT may treat material influence (and indeed ‘de facto’ control) as equivalent to control. The OFT’s practice is to treat material influence as control whenever it considers that the test for reference would be met in the case in question” (para 3.16).</i></p>
	<p>The Draft Guidelines describe the factors likely to be considered in assessing material influence, but do not state the general presumptions that are applied by the OFT in practice.</p>	<p><i>“... a share of voting rights of over 25 per cent is likely to be seen as presumptively conferring the ability material to influence policy ... the OFT may examine any case where there is a shareholding of 15 per cent or more ... exceptionally, a shareholding of less than 15 per cent might attract scrutiny ... ” (paras 3.19-3.20).</i></p>