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Merger Assessment Guidelines

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

Consultation Document

1. INTRODUCTION

1.1 We welcome the opportunity to comment on the draft joint OFT/CC merger assessment guidelines published in April 2009. Combined guidance on the assessment of mergers, setting out both the OFT and CC approach in one document, will be useful for businesses and legal advisers as it will increase transparency, clarity and legal certainty. The combined format will also be more user-friendly, thereby to some extent reducing the burden on merging parties. Given that the Enterprise Act regime has been in place for six years now, publication of this combined guidance, which reflects the Authorities' experience to date and updates as well as expands existing guidance, is timely and opportune.

1.2 The comments contained in this paper are those of Herbert Smith LLP and do not represent the views of any of our individual clients.

1.3 Our comments are set out in the order in which they appear in the consultation. We have not aimed to comment exhaustively on all points but have focused on a number of issues raised by the consultation.

2. PART 3: THE RELEVANT MERGER SITUATION

2.1 We note that the content of this section of the draft joint guidance essentially mirrors that of the OFT's jurisdictional and procedural guidance, but that certain topics which are covered in the procedural guidance have been omitted from the draft joint guidance. Describing the OFT's procedural guidance as providing "more detail" on the meaning of a relevant merger situation at paragraph 3.2 of the draft joint guidance is therefore inaccurate and potentially confusing for readers. It would be more helpful if the sections dealing with the relevant merger situation in both sets of guidance were identical.

2.2 The discrepancy between the two sets of guidance also means that there is effectively no guidance on the CC's practice in relation to the topics which have been omitted from the draft joint guidance, as the procedural guidance has been issued by the OFT only. This is unsatisfactory as in the two-phase merger control process both bodies are responsible for reaching a conclusion on whether a relevant merger situation has been created.

2.3 We feel that more practical examples and references to case law throughout the guidance would be very useful. In particular, examples to explain the different degrees of "ceasing to be distinct" and also the broad nature of the "share of supply" test, would be helpful. In our experience, non-specialists have not fully understood these concepts in the past. Whilst larger companies will generally have the benefit of specialist legal advice, many smaller companies do not.

3. PART 4: A SUBSTANTIAL LESSENING OF COMPETITION

Theories of harm

3.1 Paragraph 4.13 notes that, in cases where there are concurrent theories of harm, the Authorities may not need to reach a firm conclusion on both if they expect one to meet their respective competition test. It seems to us that, at least in cases where the parties seek to offer undertakings to the OFT to avoid a reference, the OFT would be obliged to reach a firm conclusion on all candidate theories of harm. Section 73 of the Act provides that the OFT is entitled to accept undertakings in lieu of a reference where the duty to make a reference is triggered. It cannot accept undertakings where it is "not sure" whether or not the reference test is met. Nor, presumably, can it refer a case to the CC where it is "not sure" whether or not the reference test is met. Accordingly, in such cases, if the parties offer undertakings to tackle the theory of harm the OFT is sure meets the reference test, it must "bite the bullet" in relation to any other theories of harm. The OFT should make sure that it will be transparent in setting out all theories of harm and the magnitude of their concerns to the parties in order to ensure that they have the opportunity to tackle each of them.

The counterfactual

3.2 We welcome the clear statement of the OFT's and CC's position with respect to determining the appropriate counterfactual in merger situations. We note that the draft guidance indicates that the OFT will adopt "the most competitive realistic counterfactual" (point 4.21) "even if there are other realistic counterfactual scenarios under which there would be no SLC" (point 4.22). In our view, this does not add materially to the statement that the OFT will, in practice, presume that the status quo ante will be the most appropriate counterfactual and, instead, risks generating confusion.

3.3 In respect of parallel transactions, in paragraphs 4.40 to 4.42, it would be helpful if the guidelines would expand on the reasons for not following the EC Commission's approach of 'first come, first served'. The OFT had initially mirrored this approach in its draft jurisdictional and procedural guidance, but the relevant paragraph was deleted in the final version. There is now no guidance at all on parallel transactions in the OFT's jurisdictional and procedural guidance, although the heading (in paragraph 4.78 of those guidelines) still refers to parallel mergers. It would therefore be useful if the joint guidelines would expand on this.

3.4 Although we acknowledge that the joint guidelines largely restate the current position in respect of the failing firm defence, we continue to be concerned both that the bar for successfully mounting the defence is very high and that there is significant uncertainty surrounding the way in which the OFT and CC will apply the guidelines in practice. For example, it is not clear how imminently a firm should be facing being placed into administration for its exit from the market to be perceived as "inevitable". Similarly, it is not clear precisely what is required of a failing firm to establish evidence that no substantially less anti-competitive alternative buyer exists. It is a matter of great concern to clients whether they would, in such circumstances, be required merely to make it known publicly that they would be amenable to hearing from potential bidders, or proactively to contact firms that are likely to be interested in making an offer, or even to contact all firms with the resources to make such an offer regardless of whether they have previously shown any interest in comparable acquisitions. Demonstrating that it has conducted a comprehensive appraisal of the level of interest shown by all bidders capable of making an

offer is a heavy burden for a firm already facing financial difficulty. In these times of economic uncertainty, we regret that the OFT and CC have not taken this opportunity to clarify their guidance in this area.

Market definition

3.5 We welcome the additional guidance provided in the draft guidelines on the OFT's and CC's approach to market definition and the factors they take into account. However, we think that the guidelines would benefit from including more references to past cases. Whilst each case turns on its own facts, examples help to illustrate the points being made.

3.6 We note that the OFT and CC have sought to downplay the role of market definition. Whilst we agree that market definition is not an end in itself and may not be determinative, in particular in the case of differentiated products, we do consider that market definition still plays an important role. We are concerned that a shift away from a separate market definition exercise will make it harder for companies to take a clear view on the risks involved and may also impose a heavier burden on them in terms of increased reliance on expensive and time consuming econometric analysis. In straightforward cases, which involve minimal competition concerns, this would seem disproportionate.

3.7 We note that the draft guidelines state that the OFT and CC will normally posit a price increase of 5% in applying the SSNIP test, although it may apply a different price increase in some markets. We welcome this clarification, as the slight inconsistency between the OFT's and CC's position set out in their current guidelines is unhelpful. We think that clarity as to what constitutes a "small but significant" price increase is important, in particular for the purposes of designing surveys.

3.8 The acknowledgment in paragraph 4.79 that conventional market definition tools may be less appropriate in cases involving multi-sided markets is helpful (the influence of network externalities often means that demand is more elastic than may appear from a conventional analysis (see footnote 76)). Further guidance on the approach the Authorities would take in such cases and the types of evidence that would be considered relevant would, however, be helpful. In addition, it may be worth noting (for example in point 4.97) that multi-sided products may compete with single-sided products; leading economists in the area (e.g. David Evans and Richard Schmalensee) accordingly refer to "multi-sided platforms" rather than "multi-sided markets".

3.9 There are certain areas included in the discussion on market definition in the current OFT and/or CC guidelines which we note are absent from the discussion on market definition in the draft joint guidelines. These include bidding markets and the temporal dimension of market definition. We consider that these areas would still merit some discussion in the market definition section of the guidelines.

Measures of concentration

3.10 We note that the draft guidelines seek to downplay the significance of measures of concentration. Whilst we agree that an over-reliance on market shares or concentration ratios can be misleading, we do consider that measures of concentration are a useful starting point for companies in assessing the risks involved. As with market definition, we have a slight concern that companies will be forced to carry out expensive and time-consuming econometric analysis, which may prove disproportionate in cases raising minimal competition concerns.

3.11 We also note that the guidelines no longer include a 'safe harbour' of 25% referred to in the CC's current guidelines. Instead, the guidelines note that past cases suggest that unilateral effects are unlikely where the parties have a combined market share of below 40%. We note, however, that the European Commission's guidance on horizontal mergers continues to refer to a 25% threshold. In contrast, the revised HHI figures referred to in the draft guidelines are now consistent with those used in the European Commission's guidelines.

Horizontal mergers – unilateral effects

3.12 Whilst we acknowledge the potential for error as a result of the "binary fallacy", there may be a risk that paragraph 4.47 underplays the importance of market definition in unilateral effects cases. For example, where companies compete in a broader market, competition from other sources may still be sufficient to constrain prices post-merger, even if the merger eliminates the parties' closest competitor. In general, amplification of the way in which the OFT will assess the impact of competition from other sources in such cases would be very helpful. Paragraph 4.102 for example, implies that constraint from other firms will be considered only if those firms are able to "alter their products to become close substitutes for those of the merged firm". It is not clear that, in practice, this would necessarily be the case. There have been instances where, despite compelling evidence that post-merger prices would be constrained by other products, it seemed impossible to displace the OFT's concerns based on unilateral effects and it was not clear what exactly the issues were.

3.13 The effect highlighted at paragraph 4.95 as follows: "the worsened competitive offer of the merged firm will cause some customers to switch to rival firms, thereby increasing demand for the rivals' products and allowing the rivals to worsen their offers without losing customers" seems likely to arise only in cases where coordinated effects are a likely result of the merger. In other cases, it seems likely to be difficult for the Authorities to conclude on such effects without detailed information on competitors' incentives. The risk of such effects should therefore not be overstated.

Horizontal mergers – coordinated effects

3.14 The ECJ made it clear in Impala that, in order to establish collective dominance, it will not be sufficient for the Commission to go through the relevant factors as established in the Airtours case in a mechanical way. It must apply those factors in the context of a coherent and plausible theory of coordination, specific to the case, and must demonstrate how such coordination would take place under the circumstances of the proposed transaction. The comment in paragraph 4.122 that "a merger that results in a market with two or three similarly sized firms, in which the three conditions for coordination are met (paragraph 4.117), may well be considered to give rise to an SLC on the basis of coordinated effects" creates the impression that the three conditions will of themselves be sufficient. This does not sit well with the ECJ's comment that the conditions must be applied in the context of a coherent and plausible story. The combined guidelines should follow the EC approach and it would therefore be helpful if more emphasis were placed on the requirement for the Authorities to articulate a 'story' around the mechanism.

3.15 The emphasis on existing coordination could be problematic. First of all, there is a risk that effective competition may be confused with existing coordination. Also, pre-existing cartel behaviour should not be seen as necessary evidence of coordination. If the market were sufficiently transparent to be susceptible to tacit coordination, it would not be necessary to put illegal information sharing mechanisms in place.

Non-horizontal mergers

3.16 We welcome the approach in the joint guidelines of following the European Commission's guidelines on non-horizontal mergers and adopting the analytical framework for the assessment of foreclosure set out in this guidance based on ability, incentive and effect.

3.17 The draft guidelines recognise that the commercial rationale for non-horizontal mergers is generally efficiency enhancing, but should place greater emphasis on the generally benign nature of non-horizontal mergers. Non-horizontal mergers should be addressed from the presumption that they will generate efficiencies. In addition, economic analysis of non-horizontal mergers is complex and requires evidence meeting a particularly high standard. Regulatory intervention in non-horizontal mergers should therefore be restrained and reserved to those cases where clear anti-competitive effects can be identified.

3.18 We therefore question whether it is right for the OFT, as set out in paragraphs 4.145, 4.150 and 4.165, to adopt the approach of a rebuttable presumption of foreclosure where there is ability and incentive. Non-horizontal mergers should be addressed from the presumption that they will generate efficiencies and a light touch regulatory approach should be adopted, reserving a full scale analysis only for exceptional circumstances. The presumption of foreclosure at OFT stage may result in a number or unnecessary referrals to the CC, at a high cost for businesses and potential consumer harm.

Efficiencies

3.19 Generally, we welcome the move away from the previous emphasis on "rivalry enhancing" efficiencies at the SLC stage, and the more general recognition, in this guidance, that efficiencies may prevent adverse effects and therefore prevent a merger giving rise to an SLC.

3.20 We also welcome the inclusion of examples of supply-side and demand-side efficiencies in this guidance (we will leave others to comment on those examples).

3.21 We set out below some minor comments on points where we consider this section of the guidance would benefit from clarification.

3.22 The description, in the opening paragraphs of this section, of the two distinct "gateways" when efficiencies may be relevant, is useful. However, we consider that it would benefit from minor adjustments to provide further clarification (including clarification of the context in which the discussion in these guidelines applies). In particular:

- The wording of the introductory paragraphs (paragraphs 4.200-4.202) could be adjusted to make more explicit references to each of the OFT and the CC, and to distinguish more clearly between the different stages in an inquiry at which efficiencies might be considered, so that it is clear that both the OFT and the CC may take efficiencies into account where they benefit customers and prevent a merger giving rise to an SLC, and that both the OFT and the CC may take efficiencies into account where they do not prevent an SLC but nonetheless outweigh it to the benefit to consumers (but that they do so at different stages of an inquiry).

- It would be useful if the cross-referencing were clearer and/or the wording of the introductory paragraphs were adjusted, so as to provide clearer signposts to information in relation to where a reader would find guidance on the consideration of efficiencies in the context of consumer benefits. It may be worth setting this out in the

text (e.g. saying that guidance in relation to the OFT's consideration of efficiencies in the context of its consideration of consumer benefits may be found at [x], and guidance in relation to the CC's consideration of efficiencies in the context of consumer benefits may be found at [x]). In relation to this, we note that the OFT is proposing to issue new guidance on its consideration of exceptions to the duty to refer (which we assume will include guidance on efficiencies in the context of the OFT's consideration of consumer benefits).

- The introductory paragraphs should state clearly that the paragraphs in this paper discuss the Authorities' approach to considering efficiencies in circumstances where they are assessing whether those efficiencies give rise to an SLC.

3.23 These comparatively minor adjustments would, in our view, be of particular benefit to those who are unfamiliar with the OFT/CC merger control regime.

4. PART 5: PUBLIC INTEREST CASES

4.1 The draft guidelines contain a certain amount of procedural detail that does not fit neatly with the intention of the draft guidelines to deal with substantive issues of assessment, and in particular contains some overlap with the OFT jurisdictional and procedural guidance published in June 2009 which provides very helpful details of the public interest intervention process. CC2 and CC4 also provide information on the public interest regime.

4.2 If procedural information about the public interest regime is intended to be covered in the joint guidelines, in the interests of clarity it may be preferable to replicate fully the information in the recent OFT jurisdictional and procedural guidance and to include full and updated details of procedural considerations for the CC. Alternatively, procedural considerations should be excluded entirely, merely providing references to the existing guidance on procedural aspects of the regime, so that the document relates to substantive issues only.

4.3 A third option, which we would advocate, would be to create a separate, stand-alone joint document which incorporates guidance on both the jurisdictional/procedural and substantive aspects of the public interest intervention regime (including for European public interest interventions (i.e. cases subject to the ECMR) and special public interest interventions). We consider that this option would be preferable in terms of clarity, so that the relevant information for the public interest intervention regime is available in one place, and would also allow the document to be delayed pending the final outcome of pending cases that may impact on the substantive assessment by the CC of public interest issues, without delaying the substantive guidance for cases in which the public interest regime is not invoked.

4.4 The guidelines do not provide very much information on substantive assessment issues for the CC. We are aware that this may in part be due to the pending BSkyB case. However, useful amplification could perhaps still be made in relation to, inter alia, the following:

- The approach taken by the CC in balancing the public interest considerations against competition concerns. In terms of substantive assessment, we are aware that the OFT will make an assessment on competition grounds but will refrain from advising on public interest concerns. However, the CC is required to advise both with regard to competition concerns (where a reference is made on both competition and public interest grounds) and on the specified public interest considerations, and it would be

useful to have more information on its approach. The clarification that the CC will deal with each question separately when reporting on both the SLC question and a relevant public interest question is helpful.

- Distinguishing between the various scenarios e.g.:
  - Where both the public interest consideration(s) and competition considerations point towards remedies/prohibition;
  - Where the public interest would point in favour of clearance despite an SLC (for example, would the same approach be taken as in the general SLC test where countervailing benefits are being assessed?) (e.g. where the financial stability public interest is specified);
  - Where the public interest points in favour of remedies/prohibition despite there being no SLC (e.g. media mergers).

4.5 A separate stand-alone document dealing with the special interest intervention could also cover other regimes that are 'outside the norm', such as the water merger regime, covering both the procedural/jurisdictional aspects of when the OFT will refer the merger and details of how the CC will make its assessment (as currently contained in CC9, published in 2004) with regard to the legitimate interest of the UK (as recognised under Article 21 of the predecessor to the ECMR by the European Commission in 1995) in ensuring that an adequate number of comparators (water suppliers who are independently controlled) remain on the market for regulatory purposes.

4.6 The OFT's current substantive assessment guidance (OFT 516, May 2003) explicitly states that the OFT would make a decision consistent with its advice on competition issues, following the issuing of its report if the Secretary of State decides that there is no relevant public interest consideration. This is not stated explicitly in the draft joint guidelines. The published procedural/jurisdictional OFT guidelines do state that "In any event, any decision in the case based on competition considerations must follow from the OFT's advice on whether or not it is or may be the case that the merger has resulted or may be expected to result in an SLC." (paragraph 9.8). This seems to cover both the situation where the Secretary of State decides that the public interest consideration is not relevant and where the Secretary of State does go on to make a decision in the case. However, it might be helpful to have it stated explicitly in the substantive guidelines that the OFT will take action consistent with the competition assessment in its report to the Secretary of State, perhaps in paragraph 5.9 of the draft guidelines.

4.7 Paragraph 5.9 of the draft guidelines and paragraph 9.18 of the OFT's procedural and jurisdictional guidelines refer to whether the public interest consideration is "relevant", in line with the wording in section 56 of the Act, whereas paragraph 10.6 of OFT 516 (the existing substantive assessment guidance) refers to whether the public interest issues are "material" to the outcome of the case. Referring to "relevant" rather than "material" seems to be more accurate (i.e. in line with the statute) and therefore appropriate, so we would support this change.

4.8 The cross-reference to paragraph 5.1 in paragraph 5.10 appears in fact to be intended to be a reference to paragraph 5.7.

4.9 As presently drafted, the section on media public interest cases (paragraphs 5.20-5.23) is somewhat unclear. In particular, the reference to "special merger situations" before the

notion is properly introduced (in paragraphs 5.24-5.27) is liable to confuse those who are unfamiliar with the regime. The entire section would benefit from redrafting to set out more clearly (i) the difference between "relevant merger situations" and "special merger situations" and (ii) the various "phases" of an investigation in each case.

4.10 It would also be helpful to include further detail on the various factors that the CC will take into consideration when considering public interest issues where a media merger is referred. At present, the draft barely expands on the wording of the statute in this regard. Paragraph 5.23 notes that "detailed guidance on how the media merger public interest provisions are operated is available on the BERR website", footnoting the 2004 Guidance on the operation of the public interest merger provisions relating to newspaper and other media mergers. However, apart from some limited analysis of the background to the various media considerations in paragraph 5, this guidance focuses on procedural issues.

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