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Linklaters LLP: Response to the OFT/CC's Consultation on the Merger Assessment Guidelines

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Response to the OFT/CC's Consultation on Merger Assessment Guidelines (OFT1078)

1 General Observations

We welcome the opportunity to comment on the review of the Office of Fair Trading (OFT) and Competition Commission (CC) Merger Assessment Guidelines (the "Guidelines"). These Guidelines constitute an essential tool in understanding how the Authorities are likely to approach specific questions, and this element of transparency is greatly appreciated both by us and by our clients.

We welcome the references to previous cases in the Guidelines. However, in order to make the Guidelines an even more practical tool for practitioners, it would be helpful if the Authorities included further details of the evidence, cases, judicial authorities etc, that they rely on. While we of course appreciate that the Authorities are not bound by their previous decisions, they often provide valuable additional context to the principles and examples discussed in the Guidelines.

We recognise that it is not practicable for the Authorities to update the Guidelines very often, and we would therefore encourage the publication of appropriate Practice Notes on a more regular basis.

2 Part 2 - Merger Review by the OFT and CC

OFT duty to refer mergers to the CC - At paragraph 2.4, the Guidelines state that the OFT has a "*wide margin of <u>evaluation</u> in exercising its judgement*" as to whether to refer a merger to the CC. However at paragraph 2.8, the Guidelines discuss the *"discretion" of the OFT* in the context of its duty to refer a merger. Do the Guidelines intend a difference in meaning here?

3 Part 3 - The Relevant Merger Situation

Enterprises - As a general proposition, we consider that there has long been difficulty with the definition of an enterprise. In particular, the point at which the purchase of an asset ceases to be that and becomes the purchase of part of an enterprise is far from clear. In this regard, we consider there are some difficulties with the statement in paragraph 3.8 that "in some cases, the transfer of physical assets alone may be sufficient to constitute an enterprise, for example where the facilities or site transferred enable a particular business activity to be continued". Here, the reference to a "particular business activity" is circular. Moreover, it is not specific as to the identity of the person carrying on that activity: so, is it sufficient that the transfer of the asset enables the purchaser to carry on its activity to a greater extent than was the case beforehand without transferring any part of the seller's activity to the purchaser? In our view, the merger regime should only apply where the asset transfer enables the purchaser to take over some part of the business activity previously carried on by the seller (whether or not the purchaser chooses to do so is not relevant). If that is the case, then why would there be a significant difference between physical assets and intangible assets? This is an area that would greatly benefit from an indication of the cases the OFT and CC is relying on. For example, we have looked at *HMV/Zazzi* (Case ME/4036/09), where the OFT clearly felt the question needed careful analysis and there the finding that there was a relevant merger situation was in part based on the fact that there was not only an acquisition of property, stock, fixtures and fittings, but also a transfer of goodwill and employees. Similarly, in *Home Retail/Focus Group* (Case ME/3427/07), the OFT had regard to the fact that in addition to leases, there was a transfer of employees and probably some element of goodwill transfer. Thus in neither of these cases did the OFT rely on the transfer of physical assets alone.

Control - Paragraph 3.10 refers to the Authorities' discretion, rather than duty, under section 26(3) of the Act to treat the lesser forms of control as equivalent to legal control. In that context, we think that it would be helpful to note the judgment of the CAT in *BSkyB v Competition Commission* to the effect that, once a finding of material influence has been made, there is little scope for the exercise of a discretion to decline to treat that as giving rise to common control (see paragraph 104 of the judgment).

Material influence - Paragraphs 3.15 (final sentence) and 3.16 (second sentence) refer to cases in which an operation might "*in certain circumstances*" give rise to material influence without indicating or illustrating the circumstances in which that might occur. Some further elucidation of these cases, at least by way of an illustrative example, would be helpful.

The time period for investigating mergers - In our view, the wording in paragraph 3.24 is unnecessarily complicated. We suggest the following as a simpler alternative; "*For the OFT to be able to refer a merger to the CC, it must be the case that either the merger has not yet taken place; or... the completed merger has taken place not more than four months...*'.

4 Part 4 - A Substantial Lessening of Competition

What is an SLC - The Guidelines provide, in the last sentence of paragraph 4.7, an example of a merger which is expected to result in adverse effects on businesses that are not customers of the merger parties. We find this example unclear. We wonder whether the sentence is intended to refer to "mergers that create or strengthen vertically integrated firms"?

Theories of Harm - With regard to paragraph 4.14, in a situation where concurrent theories of harm might arise, we disagree with the concept that the test for referral can be met even if it is not met on an individual basis by any single theory of harm. The fact that a merger gives rise to multiple possible theories of harm is not relevant to the OFT's "realistic prospect" threshold described in paragraph 2.4 of the Guidelines. It may affect process and timing, but it is the evidence pertaining to each theory of harm which is relevant for the substantive decision.

The counterfactual - There seems to be an inconsistency in the Guidelines as to what constitutes the relevant counterfactual. Paragraph 4.21 provides that the OFT will consider whether the merger creates a realistic prospect of an SLC when compared with the "*most competitive realistic position.*" However, paragraph 4.24 goes on to explain that the presumption that the prevailing conditions of competition are the relevant starting point for the counterfactual may be rebutted, either by evidence about a "*realistic alternative counterfactual*" that the OFT considers (given its statutory test) it should take into account in its analysis, or by evidence from the merger parties on the appropriate counterfactual. Clarification of these paragraphs would be welcomed. We believe that the OFT's point is that in general it considers the prevailing conditions of competition to be the appropriate counterfactual. If any party wishes to convince the OFT that the appropriate counterfactual is something else, they need to adduce evidence to show that the proposed counterfactual is more realistic than a counterfactual based on the prevailing conditions of competition.

We also are unclear why the OFT talks in terms of a presumption at 4.23 and the need for "compelling" evidence at 4.24. We understand that the evidential burden is likely to be greater where a party is seeking to show that absent a merger a market would have a structure other than the prevailing one, but we suggest that it is more appropriate for the Guidelines to make this clear in lay terms, rather than introducing the "reverse onus of proof" which arises via the presumption.

Reading paragraph 4.24 with paragraph 4.108, it seems to us that consideration of the prospects of new entry by one of the merger firms is considered a factor relevant to the unilateral effects

assessment, rather than formally as part of the counterfactual? Whilst the end effect may be the same (in terms of the actual decision), it would be helpful for the Guidelines to address this specifically.

Failing firm - In paragraph 4.29, the Guidelines indicate that decisions by parents to close down loss-making divisions are unlikely to satisfy the criterion of inevitability of exit. This seems to be applicable both to the OFT and the CC. However, we consider that there may well be circumstances where the parent could show that there is no basis upon which it could or would rationally continue the business. Therefore, we would welcome a slightly more nuanced approach here.

Rail Franchises - In our view, it is not necessary to limit this section (paragraphs 4.43 - 4.44) to rail franchise awards as similar issues could apply to other franchises and situations where it is certain that the existing arrangement will terminate.

Market Definition - We welcome the Guidelines' approach towards the role of market definition. Some commentators may think that it is incorrect to underplay the importance of market definition because the Authorities need to have the discipline of working through a full analysis. However, we have always believed that market definition is not an end in itself, rather one tool (of many) for analysis. We consider the Guidelines' approach a refreshing and positive change.

SSNIP test - The Guidelines state (at paragraph 4.55) that the Authorities will normally apply a price increase of 5 per cent, although in some markets a different price increase may be postulated, which could be above or below 5 per cent. We believe that in terms of creating a usable system the typical (arguably less purist but certainly more workable) 5-10% range is more appropriate.

Overlapping geographic markets - As the Guidelines cover the issue of product market chains of substitution (essentially rejecting the concept), it would be helpful for the Guidelines to indicate the position of the Authorities in relation to chains of substitution as applied to geographic markets. In our experience, overlapping smaller geographic markets can in practice give rise to larger geographic markets (and indeed often the smaller markets cannot be correctly delineated). It is possible that the Authorities accept this for some markets, but would not characterise this as a chain of substitution. In any event, clarity on this would be appreciated.

Market shares - The Guidelines significantly downplay the role of market shares, in particular for the analysis of unilateral effects. Is it suggested that in unilateral effects analysis in a differentiated product market, the Authorities will consider market shares (and concentration ratios) as the least relevant means of assessing the competitive effects of a merger?

Safe harbours and thresholds - In relation to vertical mergers, although there is no "safe harbour" per se, the Guidelines state (paragraph 4.141) that "*an upstream market share of less than 30 per cent will not often raise concern over market power in relation to anticompetitive input foreclosure*". We appreciate that this is consistent with the EC thresholds. However, given that vertical mergers are generally efficiency enhancing, should this figure not be higher?

Unilateral effects - Whilst we understand that the Authorities are seeking to move away from any suggestion that price increase is the only factor relevant in assessing SLC, we find the "worsening of competitive offer" language used in paragraphs 4.94 - 4.96 awkward. We think these paragraphs would be more readable if the concept of price reduction were used (with an explanation that this is shorthand and there may be other ways in which there is a deterioration in the competitive offering). Also, the examples at paragraphs 4.94 and 4.95 are stylised (e.g. in 4.94 there is no reference to the possibility of a partial transfer of sales; in 4.95 the customer base is

assumed to be static, but for the merger). As the Guidelines are simply trying to explain difficult concepts in a simple way, we don't suggest that the examples should be made more complex. However, we think the Guidelines should indicate more clearly than they currently do that these are simplified, hypothetical examples only.

Coordinated effects - The previous CC Merger References Guidelines contained useful commentary (at paragraph 3.43) regarding the difficulties involved in identifying coordinated effects, notably that price parallelism is not necessarily indicative of tacit collusion, it could just be evidence that the market is working effectively. We think that it would be helpful for the Authorities to include similar wording in the Guidelines in the region of paragraphs 4.120 and 4.121.

Evidence of pre-existing co-ordination - The Guidelines suggest (at paragraph 4.120) that past cartel actions and proceedings in the same product market (in the UK or elsewhere) may also indicate that the conditions for coordination are met in that market. However, as the cartel may have arisen because tacit coordination was felt to be too difficult to achieve, past cartel behaviour may in fact be evidence that the conditions for tacit coordination are not met. Whether this is so can only be determined case by case and this should be acknowledged in the Guidelines.

Application of the SLC test in cases of material influence - We would encourage the Authorities to clarify in the Guidelines whether the substantive test for a finding of an SLC can be lower or at least different in cases of material influence given that the parties would potentially have different incentives than if they had control.

Spillover effects in joint ventures - We would welcome guidance from the Authorities as to their approach to the question of spillover effects in joint venture cases.

Diagonal mergers - The treatment of this area, at paragraph 4.168, is very brief. It would certainly be helpful for the Guidelines to expand their analysis on this point, including by providing an explanation of cases where diagonal issues have arisen in the past (e.g. the EC case Google/DoubleClick). If the Authorities do not consider that thinking is as yet sufficiently advanced for this to be addressed in more detail in the Guidelines, a separate practice note in future may be helpful on this subject.

Efficiencies - We welcome the increased guidance provided in relation to efficiencies and we find the breakdown of demand and supply side efficiencies, according to type, very useful.

However, with regard to the time period for efficiencies to arise, it is perfectly realistic to expect, in some markets and in some transactions, that efficiencies may take months or in some cases years to be realised. We consider that the Guidelines should recognise that, subject to provision of the appropriate evidence, the OFT/CC will take account of efficiencies that are likely to arise within two years of the merger, with some flexibility to consider longer periods where necessary. For example where the relevant time horizon for considering anti-competitive effects is long-term (because of the time it takes for investment decisions to affect market dynamics) the Authorities should also have regard to efficiencies whose effects will only be felt in the longer term.