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Dear Tony

Review of Competition Commission and OFT merger guidelines

We write in response to the call for comments by the Office of Fair Trading ("OFT") and the Competition Commission ("CC") in relation to their joint merger assessment guidelines (the "guidelines"), published for consultation on 30 April 2009.

While recognising their different roles in undertaking first and second phase merger reviews, it is important for there to be consistency between the merger control guidance of the OFT and the CC where possible. We therefore welcome this initiative. We also welcome the fact that the guidelines take account of many of the points that we (and others) raised in the CC's earlier consultation on its *Merger references guidelines* (CC2).

Set out below are our further comments and suggestions. References in this submission are to paragraph numbers of the guidelines unless otherwise stated. This response is not confidential and may be published without redaction.

1 Part 2 - Merger review by the OFT and the CC

1.1 Error cost

In its assessment of whether to make a reference (2.5), the guidelines contain no commentary on how the potential "error cost" in not making a reference is to be assessed by the OFT. More clarity on the approach here would be valuable, given the potential chilling effect, as well as the complexities of any calculation of the potential impact of a merger on consumer welfare.

1.2 De minimis exception

The OFT's decision to accept undertakings in lieu in the "de minimis" case of the Berkshire newspaper merger (ME/3315/07, 4 February 2008) included the statement: "*the OFT has today explained that as a general policy matter it will not exercise its discretion via the de minimis exception when the harm to competition could, in principle, clearly be remedied by clear-cut undertakings in lieu of reference.*"¹

We note that the guidelines indicate (2.8) that there is a forthcoming publication on this topic, *Mergers-exceptions to the duty to refer and undertakings in lieu of reference*. The OFT should set out, either in the forthcoming publication or in the guidelines, whether the decision to accept undertakings in lieu

¹ <http://www.of.gov.uk/news/press/2008/15-08>.
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involves the application of a different standard in de minimis cases; and, if so, the degree of clarity/certainty required by the OFT in accepting undertakings in lieu in cases where the de minimis exception could otherwise have been applied.

2 Part 3 - the relevant merger situation

2.1 Relevant merger situation

On jurisdictional issues generally, there is overlap between the guidelines and the OFT's recently finalised separate merger control guidance, *Mergers - jurisdictional and procedural guidance* (OFT1021). As the guidelines explain (3.2), the OFT's separate guidance provides more detailed commentary on when a relevant merger situation will be considered to arise, and this is considered appropriate given that issues in this area are generally more likely to require consideration in the OFT's first phase merger review. However, issues relating to jurisdictional concepts such as the terms material influence and enterprise can remain contentious following referral to the CC and the CC has in the past had cause to give thorough consideration to such points. In view of this, if more detailed guidance on such concepts is not to be provided in the guidelines, they should at least confirm whether the CC will adopt a similar approach to that explained in the OFT's separate guidelines on the points covered more extensively there.

2.2 Material influence

We recommend that the guidelines offer some explanation of the extent to which the authorities recognise the differences between the various levels of control in their substantive analysis. The CC has recently found (in *BSkyB/ITV*²) that material influence over a company's policy was likely to relate to matters of strategic importance and this finding informed its SLC assessment, in that the degree of control acquired was insufficient to affect competition between the parties concerned in respect of certain activities.

2.3 Associated persons

The guidelines (3.23) contain little explanation of how the authorities will apply the concept of "associated persons"³ to determine whether and in what circumstances parties to a transaction are to be viewed as acting together to secure or exercise control. The OFT's separate jurisdictional and procedural guidance (referred to above) is also brief in its comments on associated persons.

This is a complex area. In the past the Monopolies and Mergers Commission has looked at a joint bid by existing minority shareholders which was seen as a situation involving existing and proposed mergers, and in that context it distinguished between the exercise of control and the securing of control and made clear with regard to the latter that parties may be taken to be associated persons even where their joint action does not of itself secure control.⁴ The CC subsequently found that the meaning of "secure" in this context also extended to "safeguard", for example, through shareholder arrangements prohibiting the transfer of shares for a period of time and granting pre-emption rights upon such transfer.⁵

It would therefore be helpful if the authorities could consolidate the analysis in past cases and provide more guidance on this topic.

² CC, *British Sky Broadcasting Group/ITV*, December 2007.

³ In particular, Enterprise Act 2002 section 127(4)(d).

⁴ MMC, *Mid Kent Holdings/General Utilities/SAUR Water Services*, Cm. 3514a report on the proposed merger DTI press release of 21st January, 1997 - considered under section 77 Fair Trading Act 1973.

⁵ CC, *Icopal Holding/Icopal*, Cm. 5089, April 2001.

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3 Part 4 - a substantial lessening of competition

3.1 The counterfactual

Recognising that it may be difficult to generalise over the duration of the “foreseeable future” period in which the counterfactual will be assessed, it would nevertheless be helpful if the guidelines set out the factors taken into account by the authorities in determining this (4.16).

3.2 Market definition

In moving to a framework where in certain cases the competitive effects analysis - which focuses on the interaction between, and the constraints upon, the merging parties - takes priority over the assessment of market definition, the authorities need to ensure that the constraints posed by competitors captured in the market definition exercise are not lost from their assessment of the merger (4.46).

3.3 Hypothetical monopolist test

The authorities should reconsider whether it is appropriate for the guidelines to set out a limited and definite level of 5 per cent as the price increment to be used when applying the SSNIP test (4.55), given that the OFT (paragraph 3.17 of the OFT’s substantive assessment guidance on mergers - “the OFT guidance”)⁶ and the European Commission (paragraph 17 of the European Commission’s Notice on the definition of the relevant market)⁷ both currently use a 5 to 10 per cent increment. Small and non-rounded price increments may also present problems in terms of obtaining meaningful results from customer surveys.

3.4 Product market

The guidelines suggest that, in cases where the “cellophane fallacy” applies, the authorities may consider using prices lower than prevailing prices as the starting point for their SSNIP analysis (4.58). It would be helpful, however, if the guidelines also set out when this may be the case, for example, where coordinated effects concerns arise, and how the alternative “competitive” price will be identified.

3.5 Differentiating supply-side substitution from entry

The guidelines suggest that new entry will occur over a longer period than the short run (one year), but they could usefully set out guidance on what is considered to be an appropriate period within which entry should occur in order for that entry to be considered an effective competitive constraint against an SLC (4.70). For example, the European Commission indicates that entry is “normally only considered timely if it occurs within two years” (paragraph 74 of its Horizontal Merger Guidelines (“the EC horizontal guidelines”)).⁸

3.6 Horizontal mergers - coordinated effects

3.6.1 Status of the three conditions

The guidelines state (4.122) that “a merger in a market with two or three similarly sized firms, in which the three conditions... are met, may well be considered to give rise to an SLC on the basis of coordinated effects.” This raises the issue of whether, if the three conditions for coordinated effects (4.118) are met, it is then presumed by the authorities that firms will engage in tacit or actual collusion. We assume that this is not the case and the three conditions merely set out those factors which would allow firms to collude, with the authorities then going on to consider whether those firms will in fact do so (which is consistent with the CC’s position in *Napier Brown*⁹), but if so it may be sensible to modify the language so as to avoid any suggestion of a presumption operating.

⁶ OFT, Mergers - Substantive Assessment Guidance, OFT 516, May 2003.

⁷ European Commission, Notice on the definition of relevant market for the purposes of Community competition law (97/C372/02), 1997.

⁸ European Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, February 2004 (2004/C31/03).

⁹ CC, *Napier Brown Foods/James Budgett Sugars Ltd*, March 2005.

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3.6.2 Membership of trade associations

The guidelines suggest that membership of trade associations can facilitate the exchange of information (4.128). While this is possible, the exchange of commercially-sensitive information is by no means inherent to the activities of a trade association (indeed, many such organisations are careful to avoid it) and so we suggest that the statement regarding this example is modified to acknowledge that.

3.6.3 Internal sustainability

The guidelines suggest that the “deterrence mechanism” could simply involve a reversion to normal competitive behaviour (4.129). However, in the following paragraph (4.130), the guidelines suggest that the mechanism will be more effective where it is targeted at “harming” the deviating firm. Given that an approach whereby reversion to normal competitive behaviour may of itself be treated as sufficient to satisfy the internal sustainability test could be seen as lowering the threshold for establishing coordinated effects, it would be helpful to have more clarity on when the authorities would consider the threat of reversion to a competitive (rather than punitive) price is of itself sufficiently effective to prevent deviation.

3.7 Non-horizontal mergers

3.7.1 Market share thresholds

We note that there is a lower market share threshold for vertical effects of 30 per cent (4.141 and footnotes 88 and 91) than the 40 per cent level below which unilateral effects are considered unlikely by the OFT (footnote 68). While neither of these thresholds are described as “safe harbours”, in both cases the guidelines indicate that post-merger market shares below these thresholds “will not often” give cause for concern, and to that extent they are comparable criteria. Given this, the authorities should consider whether it is appropriate to have an apparently stricter approach for vertical mergers.

We would also invite the authorities to consider an appropriate *de minimis* threshold for vertical mergers, for example, if the parties have minimal presence on the downstream market notwithstanding that the 30 per cent upstream market share threshold is exceeded.

3.7.2 Consistency with EC merger guidelines

There are a number of points on which the guidelines differ from the European Commission’s Non-Horizontal Merger Guidelines (“the EC non-horizontal guidelines”).¹⁰

For example, as regards input foreclosure, the EC non-horizontal guidelines provide examples of the circumstances in which input foreclosure might prove problematic (paragraph 34 of the EC non-horizontal guidelines); specifically acknowledge certain pro-competitive or neutral effects (paragraphs 31 and 37) and factors liable to reduce or eliminate the incentives to adopt the specific course of conduct, for example, illegality (paragraph 46); and recognise factors limiting the effects of an input foreclosure strategy (paragraphs 50 and 51).

Similarly, as regards customer foreclosure, the EC non-horizontal guidelines recognise that the propensity of the products to bundling can affect the ability to foreclose (paragraph 98); provide guidance on factors relevant to the trade-off faced by the merged firm between costs from foreclosure and gains from expanding market share or raising prices (paragraph 107); and set out factors relevant to the assessment of foreclosure through conglomerate effects (paragraphs 111 and 112).

It is unclear whether omission of similar commentary in the guidelines is for the sake of brevity, or reflects a difference of opinion, and we ask that the authorities provide further clarity on this.

¹⁰ European Commission, Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, October 2008 (2008/C265/07).

3.8 Efficiencies

The guidelines could set out the extent to which the authorities consider that efficiencies achieved by merging parties can reinforce unilateral effects, and how they balance this “efficiency offence” with the “efficiency defence” acknowledged in paragraph 4.201.

The authorities could also set out how they approach cases where the merger creates economies of scale or scope which may result both in efficiencies and increased barriers to entry.

4 Part 5 - public interest cases

It would be sensible to reflect in the guidelines the thorough consideration in the *BSkyB/ITV* case, in particular by the CAT,¹¹ of how the test relating to the sufficiency of plurality of media ownership should be applied (to the extent possible given the pending appeal).

5 Part 6 - interim measures and remedies

Since both the OFT and the CC have recently published guidance on interim undertakings and orders (in OFT1021 and CC8 respectively), we query whether section 6 of the guidelines is necessary.

We trust that the above submissions are helpful.

Yours sincerely

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¹¹ British Sky Broadcasting Group plc, Virgin Media, Inc. v (1) CC (2) Secretary of State, [2008] CAT 25, 29 September 2008.