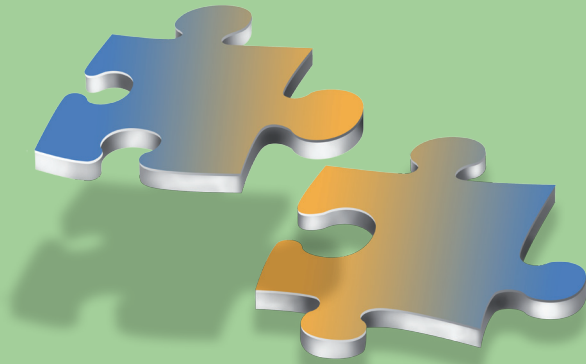


A Quick Guide to UK Merger Assessment



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Contents

Introduction	1
Merger review by the OFT and the CC	2
Who is responsible for UK merger review?	2
What are the roles of the OFT and the CC?	2
Do businesses have to tell the Authorities that they are merging?	3
What mergers can the Authorities review?	3
Does the OFT always refer a problematic merger to the CC?	4
How does a CC review differ from an OFT review?	5
Merger assessment	6
What is a substantial lessening of competition (SLC)?	6
How do the Authorities determine whether there is an SLC?	6
A Identifying the relevant markets	6
B Examining the effects on competition	8
C Assessing countervailing factors	11
How do the Authorities decide which factors to assess?	12
Remedies	13
What remedies can the CC apply?	13
Further Information	14



Introduction

Mergers can bring benefits to the economy and help businesses and markets grow. Many are pro-competitive or have a benign effect on competition. However, some can harm competition and result in, for example, higher prices, reduced quality or choice for consumers or reduced innovation. The aim of merger review is to ensure that mergers do not substantially lessen competition.

This quick guide provides a simple overview of the merger regime in the UK and the approach of the Office of Fair Trading (OFT) and the Competition Commission (CC) when reviewing mergers. These Authorities have published more detailed guidelines on the economic assessment of mergers in the **Merger assessment guidelines** (OFT1254/CC2 (Revised)). Those guidelines take precedence in the event of any inconsistency with this guide.



Merger review by the OFT and the CC

Who is responsible for UK merger review?

Merger review in the UK is primarily the responsibility of the OFT and CC (the Authorities); both are independent public authorities. In exceptional cases the Secretary of State (SoS) may intervene if the merger affects national security, media plurality or the stability of the financial system.

The European Commission (EC) examines mergers of businesses with EU or global turnover above a certain size, including those that may have an impact in the UK. Mergers that have their main impact in the UK can be transferred to the UK Authorities for examination, and some mergers that do not meet the EC's thresholds may nonetheless be transferred to it by the merging businesses or the OFT.

What are the roles of the OFT and the CC?

The assessment of mergers is conducted as a two-phase process, giving distinct but interrelated roles to the OFT and the CC.

The OFT is responsible for the first phase of the merger review process, which is usually 40 working days. The OFT has a duty to refer to the CC any relevant merger where it believes that the merger results in a realistic prospect of a substantial lessening of competition (SLC).

The CC may only examine mergers referred to it by the OFT, or by the SoS. At second phase, generally limited to 24 weeks, the CC undertakes an in-depth investigation to assess if a merger will lead to an SLC. If an SLC is likely, the CC decides upon the remedies required.

Do businesses have to tell the Authorities that they are merging?

It is not obligatory to seek approval before merging but it is strongly recommended to advise the OFT before the merger occurs. Approval before merging gives legal certainty that the merger can proceed. It can also save significant costs. If a merger is completed, either Authority can take measures to prevent the merged businesses taking actions that might pre-empt its eventual decision, and can appoint a trustee to monitor these measures at the businesses' expense. Further costs can arise from having to dispose of the merged business if the merger is prohibited (see **What remedies can the CC apply?** below).

The OFT has four months from the merger being made public, or it being completed (whichever is the later), to decide whether or not to make a reference to the CC.

What mergers can the Authorities review?

The Authorities have the jurisdiction to examine a merger (which includes acquisitions and joint ventures) where:

- two or more enterprises cease to be distinct
- and
 - either the UK turnover of the acquired enterprise exceeds £70 million
 - or the two enterprises supply or acquire at least 25 per cent of the same goods or services supplied in the UK (or a substantial part of it) and the merger increases that share of supply.

The term 'enterprise' may include whole businesses or parts of businesses, whether or not they operate for profit. Two enterprises cease to be distinct if they are brought under common ownership or control. This includes situations falling short of outright voting control.

Further information is available in **Mergers—Jurisdictional and procedural guidance** (OFT527).

Does the OFT always refer a problematic merger to the CC?

If the OFT believes that the merger results in a realistic prospect of an SLC it has a duty to refer the merger to the CC. However, the OFT may decide not to refer the merger where the merging businesses have offered undertakings (divestitures, mainly) that remedy the SLC that the OFT believes may occur. The OFT also has the discretion not to make a reference to the CC if it believes that:

- the market is not of sufficient importance to justify a reference
- there are benefits to customers arising from the merger that outweigh the effect of the SLC (see also **Efficiencies** below)
- the merger is anticipated and is not sufficiently advanced or likely to proceed to justify the reference.

Further information is available in **Mergers—Exceptions to the duty to refer and undertakings in lieu of reference guidance** (OFT1122).

How does a CC review differ from an OFT review?

Both the OFT and CC are required to consider whether there is a relevant merger situation (see **What mergers can the Authorities review?** above) and if so, whether it will result in an SLC. However, they apply different thresholds. The OFT applies a 'realistic prospect' threshold; the CC then decides whether the merger is more likely than not to lead to an SLC (that is, on a balance of probabilities).

The CC typically clears about half the mergers referred to it. In these cases no further action is taken. But if the CC finds that a merger is expected to result in an SLC, it decides what action should be taken to remedy, mitigate or prevent that SLC (see **What remedies can the CC apply?** below).

The two Authorities use the same overall analytical approach when assessing the potential effects of a merger on competition. But the different thresholds, and the need for the CC to reach a definitive view, mean the CC's investigation and analysis are deeper and broader.



Merger assessment

What is a substantial lessening of competition (SLC)?

Competition is the process of rivalry between businesses seeking to win customers' business over time by offering them a better deal. An SLC occurs when rivalry is substantially less intense after the merger than would otherwise have been the case, resulting in a worse deal for customers.

How do the Authorities determine whether there is an SLC?

A Identifying the relevant markets

In examining whether an SLC is likely to occur, the Authorities need to identify the market that is relevant to the merger. Identifying the relevant market involves an element of judgment.

What the relevant market contains depends on the type of merger:

- when one business acquires a rival (a horizontal merger) the relevant market contains the overlapping products of the merging businesses
- when a business acquires another operating at a different level in the distribution chain (a vertical merger) the relevant markets are those for the products in the same chain
- when a business acquires another that supplies different products that its customers also buy (as in a conglomerate merger) the relevant markets are those for the products sold to those customers.

As well as containing the products supplied by the merging businesses, the relevant markets may also contain the most significant competing products available to their customers.

Nonetheless, when assessing a merger the Authorities may take into account ways in which some products—inside the relevant market or outside it—compete with the merging businesses' products more significantly than others.

The same approach is applied to markets for the provision of services.

Market shares

As part of their assessment of the merger, the Authorities may consider market shares. If so, they will use a technical market with boundaries defined by testing whether or not a hypothetical monopolist could profitably raise prices by at least 5 per cent. This technical market may differ from what businesses refer to as the market that they operate in but this approach makes sure that market shares provide useful information.

If the merging businesses have a high combined share of a market that is broader than this technical market, this may indicate a problem. But the opposite is not true. A low combined share of a market broader than this technical market may still indicate a problem. Only a low combined share of this technical market indicates no problem.

B Examining the effects on competition

Unilateral effects

One way a horizontal merger can harm competition is if it removes an important competitive constraint, allowing the merged business profitably to raise prices. This is known as a ‘unilateral effect’ and is the effect that the Authorities consider most frequently.

Unilateral effects are more likely if:

- the merging businesses’ products are close substitutes and the incremental profit margins of those products are high
- customers have little choice of alternative supplier, for example because the costs to them of switching from one to another are high
- it is difficult for rival businesses to respond to price increases, for example because they have no spare production capacity
- the merger eliminates an important competitive force in the market, for example a business with a novel commercial model
- there are already few significant businesses in the market or if the merger results in a business with a large market share.

Coordinated effects

Coordinated effects arising from a horizontal merger may also lessen competition.

Coordination may arise when businesses operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate to limit their rivalry.

Coordination need not be explicit (collusion) but might emerge through repeated tacit interactions. For coordination to be effective, the market must satisfy three conditions:

- businesses need to be able to reach and monitor the terms of coordination with each other
- businesses have to find it in their individual interests to stick to the coordinated outcome
- there must be little chance of coordination being undermined by competition from other businesses, or by customers or suppliers.

The Authorities will consider the impact of the merger on the likelihood and effectiveness of coordination. Coordinated effects are more likely where:

- businesses in the market were already coordinating before the merger
- as a result of the merger, the number of businesses in the market is small
- the merger results in greater symmetry between businesses in the market.

Vertical and conglomerate mergers

Mergers are not always between rivals. Vertical and conglomerate mergers bring products together that do not themselves compete but may be related. In general, vertical and conglomerate mergers are less likely than horizontal mergers to give rise to an SLC. On the contrary, the merging businesses may benefit from efficiencies that give them a greater incentive to compete.

Nevertheless, vertical mergers may occasionally damage competition if the merged business:

- raises the costs of its downstream competitors by restricting or preventing their access to an input that it controls
- or raises the costs of its upstream competitors by restricting or preventing their access to customers.

Conglomerate mergers may occasionally damage competition if the merged business can employ selling practices that link the products in the separate markets together.

These effects of vertical or conglomerate mergers will only arise if:

- the merged business would have the ability to act this way. This is more likely if the merged business controls a sufficiently important
 - input
 - route to market or
 - product that customers want to buy as part of a bundle.

- the merged business would have the incentive to act this way. This is more likely if the profit the merged business earns on sales it gains exceeds the profit it gives up on sales it loses.
- acting this way disadvantages many competitors, and the resulting harm to competition outweighs any beneficial effects on competition from efficiencies achieved through integration.

C Assessing countervailing factors

The Authorities will also consider any factors that might prevent or significantly reduce any harmful impact of the merger. There are three main factors—efficiencies, entry and expansion in the market and countervailing buyer power.

Efficiencies

While mergers can harm competition, they can also give rise to efficiencies that make the merged business a more effective competitor. If these merger-specific efficiencies are large and timely enough, they can enhance rivalry and prevent a merger giving rise to an SLC. Efficiencies that do not enhance rivalry can also be taken into account as benefits to customers, provided that they are likely to arise within a reasonable period. However, claimed efficiencies and customer benefits can be hard for the Authorities to verify because most of the information is held by the merging businesses.

Entry and expansion

In some cases, entry by other businesses or expansion by businesses already in the market may be expected to be timely enough and sufficient to reduce any harmful impact of the merger.

However, there may be barriers to entry or expansion in the market. These barriers may be absolute, for example a patent; structural, for example economies of scale; or strategic, for example the advantage of being the first mover or pioneer in a market.

Countervailing buyer power

A customer has countervailing buyer power when it has the negotiating strength to limit a business's ability to raise prices. An SLC is less likely to occur where all customers have countervailing buyer power post-merger than where only some customers do.

A customer's negotiating strength is greater if it can easily switch its demand away from the merged business. Where a customer has no choice but to take the merged business's products, it may nonetheless apply buyer power if it can impose some costs on the merged business if it attempts to raise prices.

How do the Authorities decide which factors to assess?

The Authorities focus early in their inquiries on what factors might mean that the merger leads to an SLC. These factors are written down as hypotheses, known as 'theories of harm'. They aid the inquiry by narrowing down the issues that have to be addressed, reducing the information that has to be gathered and minimising the risk that the Authorities will pursue unproductive lines of inquiry. Theories of harm are kept under review and may be revised as the inquiry develops to maintain the inquiry's focus on the relevant factors likely to lead to an SLC.

Remedies

What remedies can the CC apply?

If the CC decides that a merger gives rise to an SLC, it will take steps to remedy the effects. For an anticipated merger, this will often mean that the merger is prohibited, although it could be allowed to proceed subject to suitable conditions, for example a divestiture of part of the business to be acquired. For a completed merger, the CC will normally seek to divest all or part of the acquired business to a suitable purchaser who can provide effective competition. Undertakings as to future behaviour may be accepted in addition to, or occasionally instead of, divestiture.

Further information is available in **Merger Remedies: Competition Commission Guidelines (CC8)**.



Further Information

Joint OFT/CC publication

OFT1254/CC2 (Revised) Merger assessment guidelines

Other OFT publications

OFT508 Overview of the Enterprise Act

OFT527 Mergers—Jurisdictional and procedural guidance

OFT1122 Mergers—Exceptions to the duty to refer and undertakings in lieu of reference guidance

www.of.gov.uk

Other CC publications

CC4 General Advice and Information

CC7 Chairman's Guidance on Disclosure of Information in Merger and Market Inquiries

CC8 Merger Remedies: Competition Commission Guidelines

www.competition-commission.org.uk

Competition Appeal Tribunal

SI 2003 No.1372 Competition Appeal Tribunal Rules

www.catribunal.org.uk

Department for Business, Innovation and Skills

www.bis.gov.uk



CC publications are available at:

www.competition-commission.org.uk/rep_pub

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