RESPONSE TO OFT CONSULTATION:
EXCEPTIONS TO THE DUTY TO REFER AND UNDERTAKINGS IN LIEU

Baker & McKenzie is grateful for the opportunity to participate in the OFT's consultation. The draft guidance is especially useful as regards the de minimis exception where OFT practice has diverged from existing guidance. Our response focuses on this aspect of the consultation.

1. DO YOU AGREE THAT ASSESSING WHETHER TO EXERCISE THE 'DE MINIMIS' DISCRETION ON THE BASIS OF A BROAD BRUSH COST/BENEFIT APPROACH IS A REASONABLE APPROACH TO THIS DISCRETION?

1.1 Section 22(2)(a) EA02 provides that the OFT may decide not to make a reference if it believes that the market concerned is not of "sufficient importance" to justify the making of a reference to the CC. The OFT's "broad brush" cost/benefit approach clearly involves an expansive interpretation of the notion of "importance" - going beyond a simple quantitative measure of market size.

1.2 This appears to go further than paragraph 97 of the EA02 Explanatory Notes (cited by the OFT in paragraph 2.5 of its draft guidance) which indicates that the issue is whether the cost of the reference is disproportionate to the "size" of the markets concerned. We suggest that this is further confirmation that the OFT should be concentrating on the objective size of the market.

1.3 However, we note a lack of clarity as regards the legislator's intent (in terms of Hansard reports etc when the OFT's duty to refer mergers was introduced). Consequently, some kind of balancing exercise may be reasonable – especially given the challenge of setting a brightline threshold which could be relied on in all cases and which was also set at a high enough level to be useful for business.[1]

1.4 However, in our view, the OFT must bear in mind that some factors fall more obviously into an assessment of market "importance" than others. The guiding principle should be that the OFT focuses on the market in which the merger is taking place - and not on wider qualitative concerns about the merger which would make use of the de minimis exception extremely difficult to rely on. For example, we query whether the recurring reference to a need for merger decisions to have a 'deterrent' effect is easily reconcilable with the statutory language. In fact, this approach appears to equate merger activity with hardcore cartel conduct, whereas the starting point should be that mergers are generally beneficial and to be encouraged. We return to this point under section 5 below.

2. DO YOU AGREE THAT THE OFT SHOULD ONLY TAKE ACCOUNT OF PUBLIC – AND NOT PRIVATE – COSTS IN CONSIDERING THE COST OF A REFERENCE, GIVEN THAT IT GENERALLY TAKES DECISIONS BASED ON A CONSUMER – AND NOT TOTAL – WELFARE BASIS?

1.5 We agree that it is appropriate to take decisions on a consumer welfare basis. However, the OFT seems to be taking an unduly restrictive view of what should be included in 'consumer

[1] The optimal situation may involve having an additional (lower) brightline threshold to complement the OFT's approach.

welfare'. It is not surprising that the OFT seeks to focus on public costs (which, naturally, it will find it easier to quantify) but, in reality, some of the so-called 'private costs' borne in the first instance by the merging parties will have an impact on consumer welfare:

- First, the significant costs of a reference may well translate into a price increase.
- Secondly, the instability caused by a reference (in terms of the altered behaviour of customers - and even employees during a period of uncertainty) may damage a business with a knock-on effect for consumers. In so far as the merger generates efficiencies there is also a negative impact as the benefits of a merger are delayed.

1.6 These factors are difficult to quantify but clearly demonstrate the need to raise the £10 million threshold.

1.7 We do not agree with the OFT's logic in paragraph 2.7 - which is that there is no need to take into account the private costs of a reference since parties "have a clear choice as to whether to pursue a potentially anti-competitive transaction and are... able to structure transactions so as to reduce the merger control risk they assume". This reasoning is unrealistic to the extent that it treats mergers as being either (i) demonstrably benign/pro-competitive or (ii) manifestly anticompetitive. It ignores the existence of mergers in between those two extremes which should benefit from the de minimis exception if they involve markets of insufficient importance.

1.8 We would also like to take this opportunity to make observations on the thresholds set out in the draft guidance (shown in the table below):

>£10m	The OFT will "generally" refer (para 2.2).
£6-£10m	Footnote 6 refers to *Eastbourne* indicating that the OFT is "unlikely" to apply the exception to a £6m market unless other factors "strongly suggest it should do so".
£3-£6m	The OFT will consider applying the exception (para 2.2).
<£3m	The OFT will generally apply the exception (para 2.14), but particular facts may result in a reference.

The £3 million threshold

1.9 As regards the £3 million threshold mentioned in paragraph 2.14, we appreciate that the OFT is merely stating the fact that markets worth less than £3 million have, to date, been treated as de minimis. However, that paragraph of the guidance is unnecessarily cautious - with three caveats. We understand that this reflects an OFT concern that a less equivocal statement might give the 'green light' for the merger to be replicated in other markets across the UK in a way which would result in a degree of consumer harm that would justify a reference.

1.10 To address this concern, we suggest that the guidance is amended to indicate that the OFT would " generally expect" markets worth less than £3 million to be regarded as de minimis. The OFT could then describe in the guidance the type of fact pattern that could be expected to make the £3 million threshold much less certain - e.g. presumably mergers involving local

markets which may nonetheless confer a degree of market power in a wider, e.g. national, market.

The £6 million threshold

1.11 Footnote 6 of the guidance appears to introduce a £6 million threshold. We wonder whether this reflects an OFT practice of codifying its historic practice, rather than setting out a principled and workable approach for the future more generally. In essence, the £6 million threshold seems arbitrary and arguably out of place given the balancing exercise being undertaken by the OFT. There may be a logic in defining the outer limits of the market size (i.e. £3m and £10+ million), but we query whether the embedding of a further threshold is consistent with the OFT philosophical approach - which involves weighing market size against other factors.

3. DO YOU AGREE THAT THE OFT'S DUNFERMLINE PRESS POLICY POSITION WITH RESPECT TO THE PROPORTIONALITY OF A REFERENCE WHERE UNDERTAKINGS IN LIEU ARE AVAILABLE IS A REASONABLE ONE?

3.1 Under the EA02, the OFT may only accept UILs where it decides not to apply any available exception to the duty to refer, including the de minims exception.

3.2 The EA02 does not therefore envisage a situation where the availability of UIL can or should 'trump' an assessment of whether a market is of insufficient importance to justify a reference. Also, with an eye on the issue of substantive harm, it would be illogical to accept UIL in respect of a transaction which, to put it bluntly, is not worth it.

3.3 The OFT appears to have decided, for policy reasons, to consider the 'in principle availability' of UILs at an earlier stage. However, we do not understand the OFT's concerns in paragraph 2.21 that if the OFT were not to adopt this approach, then the parties would not advance UIL proposals in cases that are potentially susceptible to the de minims exception. It seems to us that the OFT should proceed from a starting point that mergers are generally to be encouraged and that it should then be prepared to consider whether the market is of sufficient importance to justify the CC's costly in-depth review. If the market is of sufficient importance then that would be the logical point at which to consider UILs. It is illogical - and we would think impracticable - to look to a remedy at a point in time when the theory of harm has not even been formulated properly. In our view, the OFT appears to be overly protective of the 'deterrent' effect of UILs. UILs are undoubtedly an extremely pragmatic means of dealing with SLC mergers but there is no need to rely on this mechanism where the OFT is confident that a market is de minimis. There is only a risk of the utility of UILS being lost if the OFT sets up a de minims regime which is too easy to rely on - i.e. if the guidance were so wide that it could be invoked in an attempt to avoid UIL discussions.

4. IS IT CLEAR WHAT THE OFT MEANS WHEN IT REFERS TO UNDERTAKINGS IN LIEU BEING 'IN PRINCIPLE' AVAILABLE IN THE CONTEXT OF DE MINIMIS? IF NOT, WHAT FURTHER GUIDANCE WOULD BE USEFUL?

4.1 From a practical perspective, we wonder how the OFT will be able to assess whether UILs are 'in principle' available since we assume that only a limited analysis of potential theories of harm would have been undertaken by that stage.

4.2 Conversely, if the OFT were to follow the sequence in the EA02 (i.e. consideration of de minimis exception *and then* the availability or otherwise of UIL) this would actually put the OFT in a better position since, by the UIL stage, it would have looked at theories of harm

including (according to paragraph 2.28 of the draft guidance) the magnitude of competition lost by the merger and the durability of the merger's impact.[2]

4.3 On a potentially more theoretical but not impossible issue, we query how the OFT protects against the situation where mergers that are legitimate candidates for the application of the de minimis exception are 'undermined' by the existence of UILs - which may actually be disproportionate in light of the absence of competitive harm. There is an argument that the OFT is adopting a disproportionate stance as regards mergers in particular sectors which are particularly 'susceptible' to UILs (e.g. local markets where divestments are generally more 'clear cut').

4.4 Finally, it is not clear to us whether an UIL would still be available "in principle" if there were no buyer available. Clearly, the complexity of the OFT's approach is further compounded if the OFT has to check that there is a real buyer for an in principle UIL.

5. DO YOU AGREE THAT THE OFT SHOULD TAKE ACCOUNT OF DETERRENCE WHEN CONSIDERING WHETHER TO APPLY ITS 'DE MINIMIS' DISCRETION? IF SO, HOW?

5.1 In our view, the draft guidance places undue emphasis on the importance of deterring merger activity. In fact the OFT seems to adopt the same starting point as that adopted in relation to hardcore cartels - i.e. that they should be deterred. In reality, mergers are often beneficial for consumers. The OFT guidance should be amended to make it clear that the OFT recognizes the general benefits of mergers. In any event, the OFT guidance does not seem to acknowledge that the reference of a merger that is actually de minimis may chill merger activity.

5.2 More specifically, we believe that the OFT needs to be clearer in paragraphs 2.48 and 2.51 where the Oft refers somewhat cryptically to the concern that a number of replicated 'de minims' mergers may nonetheless result in an unacceptable degree of consumer harm. We understand the thinking if the OFT is making the point that, in a limited number of sectors, market power garnered in a number of local markets may nevertheless confer market power at a national level.

5.3 However we are less clear on the OFT's approach if the guidance (specifically paragraph 2.48) is indicating that consumer harm when looked at in aggregate across disparate and distinct local markets may result in an unacceptable degree of consumer detriment (without market power being acquired in some geographically wider market at the same time). The correct philosophical approach must be that a market is de minimis when looked at in isolation and that there is no basis for 'adding up' consumer detriment in markets in regions whose players do not exercise a competitive constraint on one another.

5.4 Finally in relation to deterrence, we note that a policy of not allowing the de minimis exception to be relied upon (e.g. where there is an UIL available in principle) could deter entry in markets where an entrepreneur wishes to enter a market in anticipation of being acquired.

[2] In fact, this would seem to be a 'protection' which arises due to the sequence of events envisaged by the EA02.

6. IS IT REASONABLE FOR THE OFT, IN CONSIDERING WHETHER TO APPLY A 'DETERRENCE MULTIPLIER', TO HAVE REGARD TO THE ECONOMIC RATIONALE BEHIND A MERGER?

6.1 References to a 'deterrence multiplier' are reminiscent of the language used in relation to cartels. Again, the OFT should include language which acknowledges that mergers are generally to be encouraged etc.

6.2 Clearly, it is reasonable for the OFT to investigate the underlying rationale for a merger. However, we think it unrealistic to expect to be able to find evidence that the "acquisition of market power was the driver of the merger".

6.3 We also wonder how the OFT will in practice be able to "consider the extent to which the rationale behind the merger could have been achieved without creating competition concerns". Attempts to 'second-guess' the parties' commercial ambitions is likely to be very difficult in practice. The OFT should at least explain how it intends to undertake this analysis.

7. THE OFT STATED IN ITS PREVIOUS GUIDANCE THAT IT MIGHT CONSIDER USE OF THE EXCEPTION LESS APPROPRIATE WHERE A REFERENCE WOULD HAVE IMPORTANT PRECEDENT VALUE, FOR EXAMPLE, BECAUSE THE CASE RAISES NOVEL ISSUES, SO THAT AN IN-DEPTH CC INQUIRY WOULD PROVIDE GUIDANCE FOR THE INDUSTRY CONCERNED. DO YOU CONSIDER THIS CAVEAT SHOULD BE RETAINED?

7.1 We do not think this caveat should be retained. It is not appropriate to 'burden' a merger in an insignificant market with the expense of becoming a precedent. There may also be a risk in using a small market as the basis for a precedent since a perception (mistaken or otherwise) could arise that the facts are specific to the smallness of the market.

8. DO YOU AGREE WITH THE OFT'S STATED INTENTION TO USE 'DE MINIMIS' TO REDUCE, WHERE POSSIBLE, THE COSTS OF A PHASE ONE INVESTIGATION?

8.1 We agree with this approach but suggest that following the sequence of the EA02 (i.e. considering UILS only once the OFT has decided not to rely on an exception to the duty to refer) would reduce costs further.

9. ARE THERE ANY OTHER MECHANISMS, OTHER THAN THOSE LISTED, BY WHICH THE OFT SHOULD USE THE 'DE MINIMIS' DISCRETION TO REDUCE THE BURDEN OF MERGER CONTROL?

9.1 It may be useful for the Informal Advice procedure to be amended so that it is possible for the parties to seek IA in respect of de minimis issues without having to advance notions of the theory of harm.

10. ARE THERE ANY CONCERNS ABOUT PARTIES BEING WILLING TO WAIVE THEIR PROCEDURAL RIGHT TO AN ISSUES LETTER AND ISSUES MEETING IF THE OFT WOULD, IN ANY EVENT, APPLY THE DE MINIMIS EXCEPTION?

10.1 We think it is a good idea for business to have this option. However, it occurs to us that the parties would need to acknowledge an SLC in order to make this waiver. This could be an issue in the event that a third party was successful in having a case remitted to the OFT by the CAT. In such a situation it would be difficult to see why the OFT would not be obliged to make a reference immediately.

10.2 In order for this to be acceptable to business, it is necessary for the OFT to build-in a process which allows the parties to argue the substantive issue once more at phase one. One option may be to develop a procedure whereby the parties can accept an SLC for the purposes of the 'fast-track' procedure.

11. IS THE RIGHT LEVEL OF DETAIL GIVEN IN RELATION TO HOW THE OFT EXERCISES ITS 'DE MINIMIS' DISCRETION? IF MORE DETAIL IS REQUIRED, IN WHAT AREAS SHOULD THIS BE?

11.1 As indicated above, we think the OFT should give more detail on the fact patterns which it wishes to deter - e.g. the cumulative effect of acquiring market power at a local level - such that it is possible for the OFT to make clear statements, e.g. in relation to the general availability of de minimis for markets worth under £3 million.

12. DO YOU AGREE THAT OFT'S USE OF THE UPFRONT BUYER MECHANISM PROVIDES A PROPORTIONATE MEANS OF ADDRESSING DIVESTMENT RISK? ARE THERE ANY RISKS AROUND THIS MECHANISM THAT MIGHT BE ADDRESSED?

12.1 We understand the OFT's preference for an 'up front' buyer during a recession (especially a 'credit crunch' where there is a lack of investment finance etc.). However, we query whether the hardening of the OFT's approach (reflected by paragraph 5.40 where the OFT indicates a presumption of the need for an up-front buyer) is a proportionate response, given that the OFT guidance will outlive the recession.

12.2 An obvious and major drawback is the additional time which this will add to the phase one procedure for M&A deals involving the UK (since completion would generally be conditional on clearance which would only come when the parties entered into the on-sale agreement).

12.3 The considerable lengthening of the transaction timetable will obviously be felt by businesses outside the UK considering whether or not to notify in the UK. Consequently, we believe that the onus should be on the OFT to establish the need for an up-front buyer (not the other way around).

BAKER & McKENZIE

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