

Mergers - jurisdictional and procedural guidance

Summary of responses to draft guidance consultation document and emerging thinking

September 2008

OFT1021

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1 INTRODUCTION AND BACKGROUND

- 1.1 On 28 March 2008, the OFT issued for public consultation the text of revised and expanded guidance covering the OFT's merger control jurisdiction and procedure under the Enterprise Act 2002 (the Act).
- 1.2 The existing guidance is currently contained in chapter 2 of the OFT's Mergers – Substantive assessment guidance (OFT 516, May 2003) and the OFT's Mergers – procedural guidance (OFT 526, May 2003).
- 1.3 Respondents to the consultation welcomed the OFT's initiative to update its guidance to take account of developments since the Act came into force over five years ago.
- 1.4 This document, published for information purposes, sets out a summary of the key issues on which stakeholders focused in their responses to the consultation and to which the OFT is giving detailed further thought prior to publishing the finalised guidance.
- 1.5 This summary document in no way attempts to be exhaustive in relation to all issues raised in the responses received, and exclusion of a particular issue from this summary does not imply that the OFT has not considered the issue.
- 1.6 The OFT has also set out at the end of the relevant chapters its emerging thinking as to its likely position on the issues set out in this document. These preliminary positions should not be taken as definitive at this point. However, they aim to provide stakeholders with an update as to how the key issues eliciting comment may be crystallised in the final guidance document.

2 SUMMARY OF RESPONSES

- 2.1 Respondents welcomed the OFT's initiative to update its guidance to incorporate its experience after five years of merger control under the Act. Respondents were also in favour of the OFT's proposed movement of its guidance on a relevant merger situation from its Substantive Assessment Guidance to the proposed Jurisdictional and Procedural Guidance.
- 2.2 The OFT received written submissions in response to its consultation from 14 law firms and four professional bodies or trade associations.
- 2.3 The large majority of the changes from the previous guidance were either actively welcomed by stakeholders or did not form the subject of comment. Where respondents welcomed the OFT's suggested approach, these issues are not discussed here.
- 2.4 The main issues arising from the responses where multiple respondents raised questions or concerns about the OFT's proposed future approach were:
- the inclusion of updated guidance on the definition of a relevant merger situation, in particular material influence being conferred through minority shareholdings or board representation
 - the proposed continuation of the unavailability of informal advice in the context of water mergers
 - the clarification of the circumstances in which the statutory merger notice procedure is appropriately used
 - the change to the threshold as to when, as a matter of practice, the OFT will seek initial undertakings, or impose initial orders, in respect of completed mergers
 - comments on the time given by the OFT between issues paper and issues meeting, and

- clarification of the OFT's procedures for facilitating agreement on undertakings in lieu in exceptional 'near-miss' cases that would otherwise be referred to the CC.

2.5 Each of these issues is discussed separately in the chapters that follow.

2.6 A number of respondents noted the absence of references to OFT decisions and/or Competition Commission reports, even where the guidance appeared to refer (albeit in generic terms) to a specific issue that had arisen in a recent case.

OFT's Emerging Thinking

2.7 *Whilst the OFT considers it important to retain the style of the guidance as a principles-based document, it recognises the value to stakeholders of being able to refer back to the text of specific decisions where the OFT has applied the theory or encountered the issue at hand, and therefore intends to provide footnote references to selected key decisions and reports in its published text.*

3 DEFINITION OF A RELEVANT MERGER SITUATION

- 3.1 The OFT's guidance on when it may find that an acquirer has the ability materially to influence the policy of the target was set out in paragraphs 3.13 to 3.16 of the Draft Guidance.
- 3.2 Paragraph 3.13 made it clear that that section '*applies for an interim period pending judicial resolution of disputed issues in the appeal against the decision in BSkyB/ITV*', a point noted by many respondents to the consultation.
- 3.3 Respondents generally welcomed the OFT updating its guidance in this area and stated they believed the guidance provided a helpful level of detail on how the OFT examines whether material influence is present in a particular situation.
- 3.4 However, a number of respondents voiced a concern that the section of the Draft Guidance addressing the issue of material influence focused too heavily on a description of the exceptional factual situations in which material influence might occasionally be found. The result of this attempt to be over-, rather than under-, inclusive was to suggest that material influence might actually be found in a greater number of situations than had previously been the case under the existing guidance. These respondents urged the OFT to emphasise in its finalised guidance the exceptional nature of many of the situations described, and to provide clear guidelines on when, normally, material influence would be likely to arise.
- 3.5 Certain respondents expressed concerns that additional factors included in paragraph 3.16 of the Draft Guidance regarding material influence through a minority shareholding created greater uncertainty for merging parties and practitioners advising them. Some argued that a number of these additional factors risked extending the concept of material influence unduly (eg by reference to the likely voting of other shareholders).
- 3.6 A concern about potential predictive uncertainty arising from the guidance led several respondents to urge the OFT to adopt a greater number of

'safe harbours' or 'rules of thumb' to assist evaluation of when the material influence threshold might be triggered.

- 3.7 When considering the possibility of board representation (without a shareholding) giving rise to material influence, most respondents accepted that this was theoretically possible, but emphasised that such factual constellations would be very unusual. In particular, respondents urged the OFT to make it clear that the OFT would have an interest in investigating such situations of potential material influence on its own initiative only, or at least mainly, where the two entities involved were competitors.
- 3.8 A number of respondents expressed concern at the prospect of material influence being found on the basis of future board representation, and urged that such situations should be limited at least to circumstances where the acquiring party currently had a right to future board representation.

OFT's Emerging Thinking

- 3.9 *When publishing the finalised guidance, the OFT will seek to ensure that the key principles as to when material influence is likely to be found will be clearly and centrally articulated. This is unlikely to constitute providing a greater number of rules of thumb than the 15 per cent and 25 per cent guideline figures set out in paragraph 3.16, as to try to give more concrete figures as 'safe harbour' thresholds would be contrary to the wording of and intention behind the material influence test.*
- 3.10 *The OFT will retain the explanation that material influence may exceptionally be found in certain factual situations (for example in the presence of board representation alone). However, it will emphasise that these situations will be rare and would not be expected to be the subject of an OFT own-initiative investigation where they did not involve competing businesses. Exceptionally, where the firms involved were competitors, the OFT might consider it appropriate to investigate such arrangements.*

4 INFORMAL ADVICE

- 4.1 The OFT's guidance on when it is prepared to give non-statutory informal advice was set out in paragraphs 4.25 to 4.41 of the Draft Guidance.
- 4.2 With a small minority of exceptions, most respondents welcomed the proposed crystallisation of the interim arrangements into finalised form, and suggested relatively minor tweaking to the current arrangements (for example, that guidance given should be able to be shared within the acquiring company receiving guidance more widely than just to the Board members (see paragraph 4.40 of the Draft Guidance)).
- 4.3 However, a majority of respondents expressed concern at the OFT's continued unwillingness to provide informal jurisdictional advice in the context of the Water Industry Act 1991 mandatory reference regime. The Draft Guidance stated that: *'The IA process is deemed unsuitable, however, for the OFT to advise on the decisive legal question of whether the structure of a transaction, designed to fall outside the Water Industry Act regime, is nonetheless caught by the relevant automatic reference provisions. Pre-notification is recommended in such a case'* (paragraph 4.35).
- 4.4 A number of respondents stressed that this position appeared to them to be anomalous given that transactions involving multiple water enterprises are by their very nature 'credible candidate cases for reference' (one of the filters for providing informal advice generally). Certain respondents argued that the impact of the OFT's refusal to provide bespoke advice in such cases was a 'chilling effect' on M&A activity in the water sector, with potential financial investors disinclined to join bidding consortia lest this prevent them in the future from acquiring even small shareholdings in a water enterprise.
- 4.5 Respondents split in terms of how this issue should be tackled. Although some called for the reintroduction of bespoke individual advice for jurisdictional issues in water mergers, others were sympathetic to the reasons why the OFT had discontinued the individual advice service for this sector and instead suggested the provision of generic, published

guidance on how the OFT would apply the jurisdictional test (and in particular the material influence and associated persons provisions) in the context of the mandatory reference regime.

OFT's Emerging Thinking

- 4.6 *The OFT is cognisant of the commercial significance of the mandatory reference regime in water mergers and of the careful analysis that is required in order to determine whether a mandatory reference is triggered in intricate consortia structures.*
- 4.7 *However, the OFT is not currently minded to reinstate individual informal advice for jurisdictional questions in water mergers. It does not consider that OFT case teams are materially better placed to give guidance on these issues than external advisers. Further, giving informal advice in such situations is disproportionately time-consuming, frequently involving consideration of multiple alternative structures.*
- 4.8 *Instead, the OFT is currently in discussions with Ofwat and the Competition Commission about whether it would be appropriate to give generic guidance on application of the jurisdictional provisions of the Act in the water regime. If it is considered that useful guidance can be given on this issue, it might form the subject of a separate guidance publication – and a separate consultation – to be published at a later date.*

5 STATUTORY MERGER NOTICE

- 5.1 The OFT's guidance on use of the statutory voluntary pre-notification merger notice procedure was set out in paragraphs 4.53 to 4.63 of the Draft Guidance.
- 5.2 The Draft Guidance acknowledged expressly that '*the benefits of the statutory pre-notification procedure are available in all anticipated merger cases that have been made public*'.
- 5.3 However, it went on to state that the statutory merger notice '*... is intended primarily for use as a fast-track procedure for transactions that do not raise any anti-competitive concerns. In practice, such transactions will generally be those that qualify on the turnover test alone and where:*
- *there are no horizontal overlaps between the parties' activities and they are not active on upstream, downstream or neighbouring markets, or*
 - *the parties' activities overlap horizontally but their combined share is below 15 per cent on any conceivable relevant market, or*
 - *the parties are only active upstream or downstream or in a neighbouring market from each other and their share on each of those markets is below 25 per cent'* (paragraph 4.55).
- 5.4 This recommended limitation in the use of the merger notice procedure prompted critical comment from a number of those responding. In the context of a voluntary merger control regime, and given the existence of a route for notification created by Parliament, some commentators considered that the OFT had sought to narrow excessively the circumstances in which a merger notice could properly be used. In particular, some respondents stated that a move to restrict use of the merger notice in this way sat uneasily with the OFT's recognition that, in certain cases, '*the parties may well decide that notification to the OFT would be either disproportionate or unnecessary*' (paragraph 4.3 of the Draft Guidance). The logic behind this statement is that, if the transaction

clearly raises no concerns, parties would be unlikely to notify at all, rather than to use the merger notice route.

- 5.5 A number of respondents argued that the merger notice was appropriate not only for cases raising no substantive issues, but also for cases in which substantive concerns arose but there was a commercial imperative to obtain an OFT decision within a relatively short, fixed timetable. Several respondents gave public bid situations as falling within this category of case.
- 5.6 Several respondents commented on the suggestion in paragraph 4.55 of the Draft Guidance that the merger notice should not be used in circumstances in which the merger qualified on the share of supply test. In making this comment, they noted that the OFT was itself clear that the reasonable description of goods or services used for the share of supply test did not necessarily equate to a relevant economic market – as such, the fact that a merger qualified on the basis of share of supply should not (even on the OFT's own terms) mean the acquirer was discouraged from using a 'fast-track' notification procedure.
- 5.7 Finally, several respondents expressed concerns about what would happen in the event that parties submitted a merger notice and then withdrew it and re-notified the transaction using an informal submission. Paragraph 4.62 of the Draft Guidance stated that: *'In such a situation, the OFT will have regard to all the relevant circumstances of the case in determining the appropriate date by which it should announce its decision as to whether or not to refer.'* A number of respondents equated this with a suggestion by the OFT that, in such cases, the administrative clock would be re-started to zero, thereby penalising the party for originally submitting by merger notice. Several respondents urged against penalising parties in this way.

OFT's Emerging Thinking

- 5.8 *The OFT reiterates its appreciation that the benefits of the statutory pre-notification procedure are available in all anticipated merger cases that have been made public. It also acknowledges that there may be certain situations in which the value of parties being guaranteed a decision on reference within 20 or 30 working days from notification of a satisfactory submission is commercially significant. The OFT is likely to amend the drafting of this section to emphasise further these legitimate points.*
- 5.9 *However, the OFT considers it important that parties submitting a statutory merger notice in cases that do raise material competition issues understand that, by choosing to give the OFT a more limited period of time in which to decide the case, they risk not maximising their chances of a phase one outcome – and the benefits of a shorter (and more certain) phase one timetable must be set against this. Further, this risk may be increased where the parties have not engaged in appropriate pre-notification discussions with the OFT before submitting a statutory merger notice.*
- 5.10 *In situations where parties have chosen to notify using a statutory merger notice, the OFT will not encourage parties to withdraw it subsequently. It does not follow from this that the OFT will re-start the clock from zero where the parties do withdraw and 're-notify' using an informal submission, equally, it does not follow (including where the case will involve an issues letter and issues meeting) that the parties will transfer to the equivalent stage of the administrative timetable. Rather, the OFT will take all the circumstances of the case and its current caseload into account in determining its future timetable in that situation.*

6 INITIAL UNDERTAKINGS AND ORDERS

- 6.1 The OFT's guidance on its use of initial undertakings and initial orders was set out in paragraphs 6.22 to 6.43 of the Draft Guidance.
- 6.2 The Draft Guidance suggested revision of the published threshold for when the OFT will seek initial undertakings in completed mergers. Paragraph 6.31 stated: '*The OFT is likely to seek initial undertakings in respect of a completed merger where there are preliminary indications that the merger raises or is likely to raise competition concerns.*' The paragraph then proceeded to give factors that might be said to give rise to such preliminary concerns on the part of the OFT.
- 6.3 The majority of respondents to the OFT's consultation argued that the threshold described above was too low, prompting the OFT to seek to obtain initial undertakings in too high a proportion of completed cases under investigation by the Mergers Group. Certain respondents also argued that this test was too uncertain, or at least too hard to predict in advance, and sought additional guidance on how the OFT would apply it in practice. In a number of instances, respondents stressed that initial undertakings should not be sought as a matter of course when a completed merger raises concerns, but only where they were necessary actually to prevent pre-emptive action.
- 6.4 The procedure for the OFT to seek initial undertakings was also the subject of comment. The Draft Guidance stated at paragraph 6.39 that '*... the OFT will not engage in a lengthy process of exchanging comments on individual undertakings in the manner of a private commercial negotiation. Given that a one-size-fits all template will, on a subset of occasions, lead to an undue regulatory burden, the OFT will provide the required flexibility not through negotiating undertakings at length up-front, but in considering subsequent waiver requests that will exempt certain specified business areas or conduct from the hold separate obligation if justified.*'
- 6.5 Although respondents generally sympathised with the OFT's desire to ensure that initial undertakings were put in place (in appropriate cases) as swiftly as possible, a number commented that the net result of this

process was somewhat opaque. Several submissions urged that the OFT publish consents or waivers that had been given pursuant to initial undertakings, whilst others called at least for the OFT to give guidance on the situations in which a consent or waiver might realistically be considered and granted.

6.6 Several comments were received on the template initial undertakings as published on the OFT website at:

www.offt.gov.uk/shared_offt/mergers/Initialundertakingstemplate.doc

suggesting that an exception be made from the basic hold separate obligation to allow for a situation in which a target business needed an injection of finance from its new parent in order to carry on functioning. Further, a small number of respondents took issue with the proposed reporting obligation on the entity giving the Undertakings as being overly burdensome in the context of an OFT investigation.

OFT's Emerging Thinking

6.7 *The OFT considers it appropriate to seek initial undertakings – in cases where they are appropriate – as soon as possible following completion of the merger. For this reason, it will typically face a decision whether or not to seek initial undertakings at a very early stage of its investigation. It is for this reason that the OFT considers that the 'preliminary indications that the merger raises or is likely to raise competition concerns' test is appropriate.*

6.8 *Under section 71 of the Act, the OFT may, for the purposes of preventing pre-emptive action, accept initial undertakings where it has reasonable grounds for suspecting that it is or may be the case that a relevant merger situation has been created. The OFT will clarify in the finalised guidance that initial undertakings will not be sought automatically in all completed merger cases – but only where the OFT considers that they are required in order to ensure pre-emptive action does not occur. Indeed, the OFT currently seeks initial undertakings in around one third of the completed merger cases it investigates.*

6.9 *In terms of how initial undertakings will be sought, the OFT's experience to date has been that – for reasons of procedural economy – asking parties to sign up to a standardised, published template set of undertakings is the most efficient way to proceed, even if consents or waivers are then subsequently required. (Indeed, provision of consent would be how the OFT would wish to deal with an injection of capital by a purchaser required to support a struggling target business.) However, the OFT acknowledges that, for reasons of transparency, there is merit in the OFT publishing on its website consents given under the initial undertakings.*

7 ISSUES PAPERS

- 7.1 The OFT's guidance on issues letters and issues meetings was set out in paragraphs 6.47 to 6.50 of the Draft Guidance.
- 7.2 The Draft Guidance stated that the issues letter '*... sets out the core arguments in favour of a reference in the case so that parties have an opportunity to respond to the outlined concerns*' (paragraph 6.47). It later provided that '*An interval of around two working days between receipt of the issues letter and the date of the issues meeting is appropriate to allow parties time to prepare*' (paragraph 6.48).
- 7.3 A significant proportion of respondents raised concerns in relation to the OFT's perceived approach to issues letters. First, respondents noted that it was preferable for the OFT to avoid detailing wholly hypothetical (or almost fanciful) theories of harm in the issues letter. Merging parties are keen to know the actual theories of harm that the case team consider are genuinely potential issues in the case in order that they can respond directly – and can prioritise allocation of resources accordingly.
- 7.4 The second, related point regarding the issues paper was the time given by the OFT to the parties to prepare for an issues meeting. Several respondents noted that this was a crucial time for the parties to marshal key evidence for their case and to respond to concerns raised by third parties. Particularly in the context of a 40 working day timetable, certain respondents considered that guaranteeing parties a minimum of two working days between the issues paper and the issues meeting was insufficient – particularly if the issues letter raised a material number of different concerns.

OFT's Emerging Thinking

- 7.5 *In its more recent cases, the OFT has tried to limit the content of the issues paper to include only theories of harm that are genuinely of concern or of potential concern. Equally, it has given guidance in the issues paper, sometimes by a form of 'grading' or 'ranking', of the extent of its concern regarding different theories of harm to try to enable respondents to focus on those issues that appear most likely to lead to the test for reference being met.*
- 7.6 *The OFT acknowledges that a window of two working days between issues letter and issues meeting is a relatively short period in which to prepare for the issues meeting (although parties will typically have a few further days after the issues meeting in which to submit a written response to the issues letter). However, it should be borne in mind that: (a) at this stage of the investigation, the OFT is itself very time-restricted given the existence of its administrative and/or statutory timetables, (b) where the individual case timetable allows, a slightly longer response period may be given (although this is unlikely to exceed three working days), (c) if the parties and the case team are liaising extensively, parties should in general be well aware of the issues under consideration before they read them in the issues letter.*
- 7.7 *In order to assist with the third part of the above points – liaison between the case team and the parties – the OFT commits between working days 15 and 20 (or 10 and 15 in the case of a statutory merger notice) to have a 'state of play' discussion with the parties, either by conference call or by way of a short meeting. This commitment would effectively codify the OFT's existing practice in this respect. The purpose of this discussion is to give the parties as much information as possible about any competition concerns including feedback from the OFT's market test, and whether or not the case team is minded, to send the parties an issues paper. This should ensure that, when an issues paper arrives, it contains few, if any, surprises. It should also reduce the practical burden on the parties of having to prepare for an issues meeting in a relatively short time period after receipt of the issues letter.*

8 NEAR-MISS UNDERTAKINGS IN LIEU OF REFERENCE

- 8.1 The OFT's guidance on when and how it may choose to exercise its procedural discretion to revert to the parties to clarify their undertakings in lieu offer in 'near-miss' cases was set out in paragraphs 8.18 to 8.23 of the Draft Guidance.
- 8.2 The OFT's suggestion of being able to revert to parties in situations where their offer of undertakings in lieu constituted a 'near-miss' – in so far as the offer only just missed being able to be described as a clear-cut remedy to the competition concerns identified – was supported by the large majority of respondents.
- 8.3 However, several respondents were nervous that the OFT's concern to ensure that the general principle remained that there was a 'one-shot' opportunity at designing and offering undertakings in lieu would mean that it overly limited the use of its 'near-miss' discretion. Indeed, some respondents went so far as to suggest that a second opportunity to offer undertakings in lieu should be given in all cases in which the parties' first offer was not successful.
- 8.4 Of those respondents that accepted the proposition of an exceptional 'near-miss' discretion, a number asked for more detailed guidelines on what situations would constitute a 'near-miss', or what the OFT meant when it stated that the discretion would be used only where the acquirer had already made a '*good faith and credible offer of undertakings*'. Presently, paragraph 8.21 of the Draft Guidance gives some guidance on what the OFT would not consider to constitute a 'near-miss'.
- 8.5 In terms of those situations that the OFT expressly provided would not constitute 'near-miss' offers of undertakings in lieu, paragraph 8.21 of the Draft Guidance stated: '*The OFT would not regard the 'good faith' and credible offer' threshold as having been reached where the parties have consciously chosen not to offer undertakings in respect of a certain level of concentration or certain overlapping locations. ... Equally, where a specific geographic locality had been identified as raising concerns at issues meeting, but the parties chose not to offer undertakings in lieu in*

respect of that locality, the OFT would not revert in the event that the decision meeting established that the test for reference was met in that locality.' A number of respondents did not appear to recognise any rationale for excluding this type of situation from the 'near-miss' category and argued rather that this limitation by the OFT could result in disproportionate references to the CC.

OFT's Emerging Thinking

- 8.6 *The OFT has employed its discretion to revert to the parties offering undertakings in lieu in several 'near-miss' cases to date. In each of them, it was clear that the parties had made a good faith and credible attempt to resolve the concerns through structural means, but the 'in principle' offer needed tweaking in order to ensure it was sufficient to warrant suspending the OFT's duty to refer.*
- 8.7 *The OFT will not adapt its remedy procedure in order routinely to give parties a second opportunity to submit undertakings in lieu.*
- 8.8 *OFT case teams now routinely engage constructively and substantively with the parties on potential undertakings in lieu (albeit that the ultimate decision as to what to offer lies with the parties, and whether to suspend the duty to refer lies with the OFT decision maker). Given the timetabling constraints of the OFT process and the nature of the undertakings in lieu procedure, parties should understand that the basic principle remains that they have one shot to make their remedies offer prior to the CRM. In this vein, they should be encouraged to offer the maximum package they are prepared to give up in order to avoid a reference to the Competition Commission. The OFT's exceptional use of its 'near-miss' discretion will operate in the context of this framework.*
- 8.9 *The OFT does not consider it helpful to seek to detail further what it regards as 'near-miss' circumstances. In determining whether to exercise this procedural discretion, it will take all factors into account in the circumstances of the case in question.*

9 CONCLUSION AND NEXT STEPS

- 9.1 The OFT is currently reviewing the issues discussed above to decide on the most suitable form of revised guidance. It is also examining a number of more discrete points made by different stakeholders on how the drafting of the guidance might best be improved in a number of places.
- 9.2 At this point, the OFT is aiming to publish finalised guidance by the end of the year.