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FAO - Tony Gooch

NON-CONFIDENTIAL VERSION

Dear Sirs

Merger Reference guidelines (CC2) - Response to consultation

Further to last month's announcement by the Competition Commission ("**CC**") that it is launching a review of its guidelines for merger references ("**Guidelines**"), we set out below a number of comments on the existing Guidelines[1].

Since the Enterprise Act 2002 came into force, Clifford Chance has advised one or more of the merging parties in a number of merger references, in particular *GAME Group plc/Gamestation Limited*; *SvitzerWijsmuller AS/Adsteam Marine Limited*; *Bucher Industries AG/Johnston Sweepers Limited* as well as the ongoing *Macquarie UK Broadcast Ventures Limited/National Grid Wireless Group* inquiry. In addition, we have been involved in the *HMV Group plc/Waterstones plc/Ottakars Plc* and *Heinz/HP Foods Group* inquiries as well as a number of recent and ongoing CC market investigations.

[1] Merger References: Competition Commission Guidelines (CC2), published June 2003. Second impression April 2007

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This letter will be structured as follows; first we set out a number of general observations and comments on the Guidelines and the context in which they are to be applied and then we will proceed to make specific comments in relation to each of the five parts of the current Guidelines.

General observations

First, we note that it is the CC's intention to publish separate guidance on merger remedies and that the section on remedies in the current Guidelines will be substantially shortened. Consequently, we have made only limited comments in relation to remedies, although frequently it is the issue of remedies - both the actual choice of remedy and the process by which that choice is arrived at - that can be the most contentious aspect of a merger inquiry.

Secondly, we would welcome any initiative that would simplify or streamline the merger inquiry process, reduce the burden on merging parties and make the CC's analytical process more predictable and transparent. Although perhaps outside the immediate remit of the CC's current review, we think the following observations are helpful in setting the context within which the Guidelines are intended to operate:

- The timing of the UK merger review process and in particular the CC's second phase inquiry is unusually long by international standards. To the CC's standard 24 week timetable must be added the Office of Fair Trading's ("**OFT**'s") administrative timetable of 40 working days[2] plus (when final undertakings or a final order are to be put in place) an additional period of time (often running into several months) following publication of the final report before the transaction can complete (in the case of anticipated mergers) or before full integration can occur (in the case of completed mergers). This is considerably longer than most national merger review processes. In Germany for example the entire process (phase I and phase II) takes 4 months, in France the equivalent period is approximately 5 months and Ireland 4 months. Unlike some merger regimes, there is no realistic prospect of shortening this process - under the EC Merger Regulation for example, the European Commission may accept remedies prior to the issue of its Statement of Objections - although the CC regularly reviews cases which are of much less complexity and economic significance than those examined by the European Commission in phase II proceedings. By way of illustration, at the time of writing, the only merger reference currently under investigation by the CC involves the acquisition of a single cinema.[3]
- The information burden on the merging parties, particularly in the early stages of an inquiry, is intensive. This is exacerbated by the fact that this is the stage in the inquiry

[2] The OFT's 20 working day statutory timetable is generally considered by the OFT not to be appropriate for more difficult cases, in particular those which are likely to lead to a CC reference.

[3] *CineWorld Group plc/the cinema business of Hollywood Green Leisure Park, Wood Green*. Note that this excludes a further three merger references for which the final report has been published but undertakings have not yet been finalised (although note that one of these involves the acquisition of a single grocery store).

process during which (for completed mergers) the issue of interim undertakings is also being addressed - an issue which can absorb significant amounts of time. This is of course demanding for the CC inquiry team and the merging parties alike, although it imposes a much greater cost on the merging parties. Legal fees alone for a CC inquiry can easily exceed £1 million and that excludes internal costs such as management time, the costs of any legal fees incurred during the OFT process and the costs of other external advisors such as economists.

The consequence of this is that the mere prospect of a CC merger inquiry can have a chilling effect on UK merger activity. Out of the 66 references that have been made since the Enterprise Act came into force, more mergers have been abandoned on reference (20) than have been blocked (5) or cleared with undertakings (16). This represents a rate of abandonment of 30% - which is high, particularly given that an increasingly large proportion of completed mergers are being referred (for which abandonment is not an option). By contrast, over a comparable period the European Commission initiated 55 phase II proceedings under Article 6(1)(c) of the EC Merger Regulation, only nine of which were subsequently withdrawn (the equivalent of 16%)[4]. Any steps which might make the CC merger inquiry process more transparent and predictable are therefore welcome. The revised Guidelines will have a role to play in this.

Thirdly, the bi-cameral nature of UK merger control can also lead to a lack of clarity over where the issues lie at the outset of the CC's inquiry. This can lead to issues surfacing relatively late in the process leaving the merging parties with little time to respond. Whatever the content of the Guidelines, it is essential that they are implemented within a procedural framework that recognises the importance of early and constructive engagement and pro-active case management.

Finally, since the Guidelines were initially published nearly five years ago, there has been a substantial body of case law and practice developed by the CC and (in a number of instances) by the Competition Appeal Tribunal ("**CAT**"). It would add greatly to the value of the Guidelines if the experience and insight gained from previous inquiries and appeals could be reflected in the revised Guidelines. This would assist lawyers and clients alike with an understanding of how the CC has addressed specific legal or economic issues within the context of actual transactions. In the present Guidelines there is an over-reliance on economic theory and little consideration given to the circumstances in which one approach may be preferred to another. Inquiry reports then typically go through the various approaches set out in the Guidelines whether or not they are relevant to the inquiry in question. The current Guidelines have not contributed greatly to our ability to advise clients on the CC's likely approach to a given case. As well as incorporating examples of specific inquiries, the CC may also wish to consider specifying in the Guidelines, the approach it would typically expect

[4] Source: http://ec.europa.eu/comm/competition/mergers/statistics.pdf. These numbers reflect cases notified from 2003 until 31 January 2008.

to take for certain types of merger - for example, to differentiate its approach in retail mergers to those, say, in the manufacturing or transport sectors.

In the sections that follow, we have made occasional reference to specific cases which we believe are of relevance to the issues covered, but suggest that the revised Guidelines should do this in a systematic way.

Part one: Introduction

We suggest that the following areas might benefit from greater clarity in the revised Guidelines:

- The issue of enterprises ceasing to be distinct (paragraph 1.15 of the Guidelines) and in particular the question of what level of interest the CC believes is capable of constituting material influence. The final report into the *BSkyB/ITV* transaction suggests a shareholding of 7.5% might be sufficient to confer material influence - somewhat lower than has been found in previous cases. The CC examined this question in considerable depth during that inquiry and the matter is currently being considered by the CAT. This issue is key to one of the two principal questions which the CC must determine during a merger inquiry and has a much broader significance as it underpins the application of the UK merger system. Consequently, it would merit more detailed consideration within the revised Guidelines - without seeking to duplicate the OFT's guidance on the same issue.

- The application of the share of supply test and in particular the issue of what constitutes a substantial part of the United Kingdom (see paragraph 1.18 of the Guidelines). Like the question of material influence, this issue can be key to the question of whether a relevant merger situation has been created and it also has a broader significance. Cases such as *Vue Entertainment Holdings (UK) Limited/A3 Cinema Limited* have considered the nexus between jurisdiction (application of the share of supply test) and the substantive finding of a substantial lessening of competition ("**SLC**"). Other cases such as *Tesco/Co-op store in Slough* and the recent *CineWorld Group Plc/Hollywood Green Leisure Park, Wood Green* reference may help clarify the criteria by which the CC will consider whether a given part of the UK is "substantial" and perhaps even set some limits on the concept.

Please also note the following comments:

- Paragraph 1.7 should now presumably also refer to Article 4(4) of the EC Merger Regulation in addition to Article 9.

- It would be helpful to clarify in paragraph 1.19 that, in deciding the question of whether or not a merger results, or may be expected to result, in an SLC, the standard applied by the CC is the balance of probabilities. It would also help if the CC could clarify whether it believes that it must apply this evidential standard to each element of

its analysis on whether or not an SLC has arisen (or is likely to arise) or whether it must satisfy itself on the balance of probabilities that, overall, an SLC has or has not arisen. We suggest that the CC should apply the balance of probabilities standard at each stage of its analysis - thereby making it easier for the merging parties to focus their response to the provisional findings on those issues which are most relevant.

Part two: Market definition

The Guidelines refer to market definition as a framework for the examination of competitive effects (see paragraph 2.2) rather than an end in itself. We consider that whilst that may be true to a degree, it is important not to minimise the significance of market definition in a merger analysis. Market definition provides the intellectual basis for the presence or absence of an SLC. It also helps establish some degree of precedent within a given market and that in turn makes the assessment of future mergers in the same or similar markets easier to undertake, thereby enhancing legal certainty.

There has been a tendency in some inquiries for the CC to focus on the issue of competitive effects to the neglect of market definition. For example in the *Tesco/Co-op Slough* inquiry, the CC adopted a market definition that included (at the time of the merger) three competing fascia in addition to those of the merging parties and yet in the CC's analysis of the competitive effects of the merger, these stores were effectively discounted as being able to constrain the merging parties' stores.

These examples show a conflict between the outcome of a market definition driven approach (which recognises the constraints posed by third party competitors) and a competitive effects approach (which focuses specifically on the interaction of the merging parties). We see this conflict as being damaging to the process in that it can create the impression that the goal posts are being moved part way through the process. It also makes it considerably more difficult to assess the outcome of the process[5] and provides little guidance for any future transactions within the same or similar industries.

As a separate point, we note that this part of the Guidelines focuses almost exclusively on the application of the SSNIP test. It should also be noted that in a number of inquiries, the CC has not employed the SSNIP test approach to market definition - for example in *SvitzerWijsmuller AS/Adsteam Marine Limited* and *Academy Music Holdings Limited/Hamsard 2786 Limited.* Expanding on these and similar examples would help clarify the likely direction of the CC's thinking in subsequent cases.

Part three: Assessment of the competitive effects of a merger

Please note the following specific comments:

[5] See paragraph 4.10 of the Guidelines, where the CC expresses an expectation that the parties to a completed merger will have been able to assess the risk and the cost of any likely disposals.

- Paragraph 3.4. The statement that "*a combined market share of 25% or above ... would normally be sufficient to raise potential concerns*" is cautious and not particularly informative. The European Commission, in its guidelines on horizontal mergers suggests that it is only in exceptional circumstances that transactions leading to a market share of 40% or less may give rise to concerns[6]. It is also the case that the OFT has cleared many mergers which resulted in a combined market share of greater than 25% - sometimes significantly so. See also paragraph 3.23 of the Guidelines.

- Paragraph 3.8. One concentration measure not mentioned here is fascia counting - a tool that has been commonly used in local retail markets and in particular grocery retailing (see for example *Somerfield/115 Morrison stores*). Examples of the types of markets where the CC considers this approach to be useful would be a helpful addition to the Guidelines.

- Paragraph 3.10. Note that the European Commission's guidelines on horizontal mergers adopt a slightly different approach to the interpretation of HHI results. A highly concentrated market is one above 2,000 (rather than the CC's 1,800) and a transaction on such a market is unlikely to give rise to concerns if the delta is below 150 (rather than the CC's 50). Both the CC and the European Commission would consider a market with an HHI score of 1,000 concentrated, but a delta below 250 would not generally concern the European Commission, whereas the CC would have concerns when the delta exceeded 100. Whilst accepting, that HHI is only one measure of concentration, we believe that the European Commission's approach is a more reliable guide in identifying real concerns.

- Paragraph 3.28. In addition to the unilateral effects and co-ordinated effects theories of harm, the CC has also referred to a multilateral effect (see for example the *Stonegate Farmers Limited/Deans Foods* inquiry). Further expansion on this and examples of the CC's applications of the co-ordinated/non co-ordinated effects doctrines would be helpful.

- Paragraph 3.37. Little guidance is given on the level of concentration that might give rise to co-ordinated effects - although there has been some helpful debate as to this in previous inquiries, such as the report on the *Safeway* mergers.[7]

- Paragraph 3.62. In addition to the paragraphs on what might constitute a failing firm, it would also be helpful if the CC could expand on when a firm might be considered to be a "flailing firm" - in other words, one which is not insolvent (or imminently expected to be so), but rather one which is not competing effectively. For example in the *Arla/Express* inquiry[8], the CC recognised that Express Dairies' inability to invest

[6] See recital 17 of the European Commission's guidelines.

[7] Note that this was considered under the Fair Trading Act.

[8] Also considered under the Fair Trading Act.

diminished its impact as a competitor and that the merger with Arla Foods would allow the merged entity to better compete with the two leading milk processors. A similar approach was taken in relation to the consideration of the *Morrisons/Safeway* merger.

- Paragraph 3.64. Since the initial publication of the Guidelines, the European Commission has issued guidelines on non-horizontal mergers. These contain a welcome recognition that vertical mergers in particular may be pro-competitive in that there may be substantial scope for efficiencies[9]. A similar recognition would be welcome in the revised Guidelines.

Part four: Remedial action

As noted above, given that the CC intends to issue a separate paper on remedies and substantially shorten the remedies section in the Guidelines, we will limit our comments only to the following:

- In paragraph 4.10 of the Guidelines, the CC states that (unlike the case for anticipated mergers) "*for completed mergers the CC will not normally consider the costs of divestment as it is open for the parties to make merger proposals conditional on competition authorities' approval*". This is an unrealistic and unfair distinction - as noted above, the UK merger review process is significantly longer than most other jurisdictions. Assessing the outcome of that process is difficult; assessing the impact of potential disposal costs a year or more before they are incurred is more difficult still. In any case, completed mergers are becoming the norm - half of the references made in 2007 were in respect of completed mergers (six out of twelve) and two-thirds of the rest (four out of six) were abandoned shortly following reference, meaning that only two anticipated mergers made it as far as a final report (and only one of those required undertakings).

- Another area where further guidance would be helpful is the issue of where a divestment remedy is required, the extent to which the merging parties may choose whether to divest the acquired business or the overlapping part of the acquiring business. This has been considered by the CAT in the *Somerfield/115 Morrison stores* case in the context of local markets and grocery retail and has come up in a number of inquiries - such as *SvitzerWijsmuller AS/Adsteam Marine Limited* (where the merging parties had a choice of which of their Liverpool businesses was divested), *Stonegate Farmers Limited/Deans Foods* (where the merging parties did not) and *Tesco/Co-op Slough* (where the CC did not require a divestment of the larger acquiring party's store). This can often have a significant commercial impact.

[9] See for example paragraph 13 of the European Commission's Notice on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings.

- The Guidelines could also usefully clarify the CC's approach to relevant customer benefits. At present, the Guidelines do little more than recite the relevant provisions of the Enterprise Act and they do not set out the analytical framework within which the CC assesses the impact of relevant customer benefits on the various remedies it may be considering. In particular, the Guidelines do not explain the process by which the CC tests potential remedies against the relevant customer benefits it has identified.

Part five: Public interest cases and special public interest case

We have no comment on this part other than to note that the text may need updating to reflect changes brought in by the Communications Act 2003. In addition, we would also expect that the ongoing appeal of the *BSkyB/ITV* case may provide a number of instructive points that could be incorporated into the revised Guidelines.

We would be happy to respond to any queries you may have in relation to the above. Please contact Richard Blewett on the telephone number at the head of this letter in the first instance.

Yours faithfully

Clifford Chance
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