Recent Developments in UK Merger Control—Establishment of Solid Foundations for the New Regime

*David Went**

Competition policy; Office of Fair Trading

Introduction

Four years have elapsed since the entry into force of the new UK merger control regime under the Enterprise Act 2002 (the EA 2002) in June 2003. The first two years of the new regime were marked by two notable defeats for the Office of Fair Trading (the OFT) before the specialist Competition Appeals Tribunal (the CAT). These appeals clarified the OFT's duty to refer cases to the Competition Commission (the CC), arguably increasing the likelihood of references in marginal cases, highlighted the OFT's obligation to ensure that its decisions are supported and substantiated by sufficient evidence, and emphasised the need for the OFT to consult third parties on factual matters relating to them.[1] Since the beginning of 2006, while the OFT has not been free of criticism from the CAT, it has successfully defended two appeals (including the first one brought by a merging party) and was awarded its full costs in the most recent appeal. The CC has also successfully defended two appeals before the CAT.

This paper charts developments in UK merger control from January 2006 until the end of August 2007. In addition to OFT and CC successes before the CAT, it is possible to tease out a number of themes during this 20-month period:

1. While the OFT has come under renewed pressure to ensure that its decisions are sufficiently well reasoned, it has shown that it is capable of taking robust decisions at first phase, clearing transactions resulting in high shares and raising potential concerns even in the face of determined complainants. The OFT was widely praised, for example, for its decision to clear *Boots/UniChem* subject to the parties divesting stores in 96 overlap areas.[2]
2. Since the CAT's September 19, 2006 judgment in *Stericycle International LLC v Competition Commission* (*Stericycle*),[3] there has been a marked increase in the number of completed mergers being subjected to hold-separate undertakings at first phase, arguably turning the United Kingdom into a quasi-mandatory merger control regime at least with respect to a sub-set of mergers.
3. There is evidence that the OFT and the CC may be becoming more strict in their approach to merger remedies. First, the OFT for the first time imposed an upfront buyer-type solution in *Tetra Laval/Carlisle*. Secondly, there have been more cases involving so-called "crown jewel" or alternative remedies. Thirdly, given problems arising from the remedies accepted by the OFT in *National Express/Prism Rail*, the OFT has indicated that it will less likely accept behavioural undertakings involving price controls in future—the CC also appears to be taking the same stance.
Moreover, the CAT has confirmed that it is legitimate for both the OFT and the CC to take restoring the status quo as the starting point for merger remedies, with the notifying parties having the burden of demonstrating to the OFT's or the CC's satisfaction that a lesser remedy adequately resolves the competition concerns. The CAT has also confirmed that the OFT and the CC have a broad margin of appreciation in assessing

* Sidley Austin LLP, London.

1 *IBA Health Ltd v The Office of Fair Trading* [2003] CAT 27 and, on appeal to the Court of Appeal, *The Office of Fair Trading v IBA Health Limited* [2004] EWCA Civ 142; and *UniChem v Office of Fair Trading* [2005] CAT 8.

2 OFT decision of February 6, 2006. During 2006, the OFT assessed 112 notifiable transactions, of which 13 (12%) were referred to the CC and seven (6%) were subject to undertakings in lieu. During the first eight months of 2007, the OFT assessed 66 notifiable transactions, of which seven (11%) were referred to the CC and four (6%) were subject to undertakings in lieu. These figures are in line with the statistics in 2004 and 2005.

3 [2006] CAT 21.

whether to accept particular remedies or proposed purchasers.

4. In June 2007, the OFT published for consultation revised guidance on the criteria it will apply when deciding not to make a reference because the markets involved are not of sufficient importance to justify a reference. The OFT proposes to raise the market size threshold from £400,000 to £10 million, although there will be a number of important caveats under the new regime.

The remainder of this paper considers these and other issues in the following order: jurisdiction; initial undertakings; the test for reference; evidential issues; the failing firm defence; the relationship between UK merger control and the Chapter I and II prohibitions; the OFT's robust stance; OFT referral decisions; and remedies. The last section provides some concluding remarks.

Jurisdiction

The OFT has continued to interpret the share of supply test under the EA 2002 so as to confer a broad jurisdiction on the OFT. At the same time, the OFT has confirmed that it does not exercise extraterritoriality with respect to UK merger control. The OFT has also shown that it adopts the same approach as the European Commission to assessing the reviewability of outsourcing contracts under merger control rules.

Pursuant to s.23(3) of the EA 2002, the share of supply test must be satisfied with respect to the United Kingdom as a whole or a "substantial part" of the United Kingdom. In *Torex/Retail-J*,[4] the OFT considered that the share of supply test was met with respect to the supply of electronic point of sale software systems to the "tier 2" retail sector comprising around 200 retailers in the United Kingdom. In *Montauban/Simon Group*,[5] contrary to the parties' submissions that the OFT lacked jurisdiction, the OFT considered that the Humber Estuary, on which the parties exceeded a 25 per cent share of stevedoring services, qualified as a substantial part of the United Kingdom since it is the third busiest port region in the United Kingdom, with the vast majority of UK international trade being transported by sea.[6] The OFT agreed with the parties in *Lloyds Pharmacy/Pharmacy Care Centres*[7] that the share of supply test was satisfied with respect to five primary care trusts which, although not geographically contiguous, constituted a "substantial part of the UK" representing around 2 per cent of UK population in the aggregate.[8]

Several third parties (including the Mayor of London) argued in *Nasdaq Stock Market/London Stock Exchange* that the transaction would result in a substantial lessening of competition with respect to listing services to non-UK issuers.[9] Both Nasdaq and the London Stock Exchange provide listings for non-UK companies (particularly Chinese, Indian, Russian, Canadian, Israeli and Brazilian) seeking a deeper or better-suited pool of capital that cannot readily be provided by their home stock exchanges or capital markets. After confirming that it:

> "[C]onsidered it appropriate that its substantive assessment of a proposed transaction . . . [should] focus on the issue of harm to competition and customers in the UK, rather than extraterritorial effects,"

the OFT examined whether the market for providing listing services to non-UK companies could be deemed to "operate" in the United Kingdom as required by s.22(6) of the EA 2002. The OFT noted that it was likely that a market could be said to operate in the United Kingdom only where there was at least one UK customer, but could not identify any UK customers in the market for providing listing services to non-UK issuers. Indeed, non-UK incorporated companies confirmed to the OFT that the decision regarding secondary listing was taken at head office level in the company's home jurisdiction. Recognising that the issue of where competition in the market is considered to take place might be relevant, the OFT noted that the European Commission normally attributes this to the location of the customer and that the relevant customer location in this case is the non-UK head office. The OFT also pointed to the fact that the main stock exchanges have local sales offices or representatives in China suggesting the need for

4 OFT decision of December 4, 2006.

5 OFT decision of August 2, 2006.

6 By contrast, in *Johnston Press/Local Press*, OFT decision of May 5, 2006, the OFT considered that Derry in Northern Ireland did not constitute a substantial part of the United Kingdom given that its small population of 178,200 people over the age of 15 represented only 0.4% of UK population.

7 OFT decision of June 8, 2007.

8 This was consistent with the CC's approach in *Archant Limited/Independent News*, CC decision of September 22, 2004. See also *Vue Entertainment Holdings (UK)/A3 Cinema*, CC decision of February 24, 2006.

9 OFT decision of January 18, 2007.

a local presence to compete effectively.[10] Finally, the OFT disagreed that the presence of the London Stock Exchange in the United Kingdom was a sufficient basis for jurisdiction.[11]

In *Exel Europe/NHS Logistics Authority*,[12] the OFT determined that it had jurisdiction over a transaction involving the acquisition by Exel Europe of an operating division of the NHS Business Services Authority (an executive agency of the Department of Health) notwithstanding that the business being acquired provided dedicated in-house supply chain services to the English NHS and achieved only limited merchant sales. Since the contracts and assets being transferred had an open market value, the OFT considered that they constituted enterprises for the purposes of the EA 2002. The turnover test was satisfied based on both the current annual operating costs of the in-house services and Exel's anticipated remuneration during the first year of the outsourcing contract.[13]

United Kingdom becoming a quasi-mandatory merger control regime?

In contrast with most jurisdictions around the world, UK merger control law does not require merging parties to notify mergers satisfying the relevant jurisdictional thresholds. While proposed mergers are frequently pre-notified to the OFT on a voluntary basis, merging parties are perfectly entitled to complete and implement notifiable transactions without pre-notifying the OFT or to complete transactions during the OFT's review.[14] Once the OFT becomes aware of a notifiable transaction, where it is concerned that pre-emptive action on the part of the merging parties might prejudice the outcome of any reference to the CC or any remedial action required, it can nevertheless seek initial undertakings or impose an order aimed at holding the parties' businesses separate.[15] Although the OFT can seek initial undertakings as soon as it has reasonable grounds for suspecting that it is or may be the case that a relevant merger situation has been created, it has said that in practice it will not likely seek initial undertakings with respect to completed mergers unless reference is a real possibility.[16]

Until recently, the OFT had not made much use of these hold-separate provisions. In 2004, initial undertakings were given in three cases (one of which was cleared by the OFT), representing 4 per cent of all completed mergers reviewed by the OFT that year and 20 per cent of completed mergers satisfying the reference test.[17] In 2005, they were given in four cases (one of which was cleared by the OFT), representing 7 per cent of completed mergers reviewed that year and 27 per cent of completed mergers satisfying the reference test.[18] In 2006, they were given in six cases (two of which were cleared by the OFT), representing around 12 per cent of completed mergers reviewed that year and 36 per cent of completed mergers satisfying the reference test.[19] This is perhaps not surprising in a voluntary regime in which the merging parties can choose to complete notifiable transactions at their own risk pending clearance.[20] However, there are signs of a change in this situation following the CAT's September 19, 2006 judgment in *Stericycle* in which the CAT criticised the OFT for not obtaining initial undertakings sufficiently quickly and because the undertakings lacked

10 The fact that marketing discussions might occur outside the company's home jurisdiction in the country of the relevant stock exchange did not alter the OFT's view.

11 The OFT typically defines markets based primarily on customer location rather than supplier location. See also *NYSE Group/Euronext*, OFT decision of October 9, 2006; and *SBC Communications/AT&T*, OFT decision of August 23, 2005.

12 OFT decision of July 19, 2006.

13 The OFT's approach is consistent with that of the European Commission. See Commission Consolidated Jurisdictional Notice para.163.

14 As soon as a transaction has been referred to the CC, ss.77 and 78 of the EA 2002 impose certain obligations on the merging parties. With respect to completed mergers, the acquirer is prohibited from taking further integration steps; in the case of anticipated mergers, the acquirer is prohibited from acquiring any shareholding in the target. The CC can, and typically will, also seek hold-separate undertakings or impose an order pursuant to ss.81 and 82 of the EA 2002 to reinforce or supplement the prohibitions in ss.77 and 78.

15 EA 2002 ss.71 and 72.

16 OFT publication, *Mergers—Procedural Guidance* (2003), Ch.5.14.

17 In 2004, the OFT reviewed 68 completed mergers, of which 10 were either referred to the CC (five) or subject to undertakings in lieu (five).

18 In 2005, the OFT reviewed 55 completed mergers, of which 11 were either referred to the CC (eight) or subject to undertakings in lieu (three).

19 In 2006, the OFT reviewed 49 completed mergers, of which 11 were either referred to the CC (seven) or subject to undertakings in lieu (four). As discussed below, in three of the six cases in which initial undertakings were given, the initial undertakings were given after the CAT's judgment in Stericycle.

20 While the United Kingdom's voluntary merger control regime entitles merging parties to assume the risks (and costs) associated with closing a transaction that might be subject to a reference and subsequently prohibited, the UK authorities also have the risk that any remedial action required might be rendered meaningless through the integration of the parties' businesses.

clarity. During the first eight months of 2007, initial undertakings were given in 11 cases (six of which were cleared by the OFT), representing 46 per cent of completed mergers reviewed during that period and 100 per cent of completed mergers satisfying the reference test.[21] While this increase in the use of initial undertakings might to some extent be attributable to other factors, it likely stems in large part from the CAT's judgment in *Stericycle*.

It is worth briefly considering that case in more detail. The parties, who accounted for a significant share of high temperature treatment of healthcare risk waste, had completed the transaction on February 27, 2006 within seven days of Stericycle obtaining exclusivity and then immediately forged ahead with integration, continuing to integrate their businesses even after giving initial undertakings to the OFT.[22] Indeed, while the OFT review was underway, the senior manager of the target company was given a prominent role in the integrated senior management structure of the merged business.[23] The OFT had initially contacted the parties for information the day after completion. It was not until May 18, 2006, however, two-and-a-half months later, that the OFT sought initial undertakings. On referral of the transaction, given concerns regarding the level of existing and continuing integration, the CC imposed hold-separate provisions and appointed a hold-separate manager to act as CEO of the target's business. On an application for judicial review of the CC's decision to appoint a hold-separate manager, the CAT held that the CC has a considerable margin of appreciation[24] and that it had acted reasonably in all the circumstances. In setting out the relevant context justifying appointment of the hold-separate manager,[25] the CAT commented that:

> "[P]art of the problem in this case stems from the fact that the OFT's intervention as regards pre-emptive action came rather late in the day . . ."

and that it seemed, "unfortunate that the initial undertakings given to the OFT lacked clarity".[26]

Following this judgment, the OFT will in future adopt a more cautious approach as to whether initial undertakings are required and will insist on them in more cases as already demonstrated by the current trend.[27] Moreover, it is arguable that, at least for a subset of notifiable mergers, the UK regime has taken on the feel of a mandatory merger control regime, i.e. where there is a bar on closing until the transaction has been cleared by the relevant regulatory authority. Of course, a vital distinction between mandatory merger control regimes and the UK regime is that parties can close transactions before notification, thereby releasing the seller from any antitrust risk associated with the sale.[28]

21 In the first eight months of 2007, the OFT reviewed 24 completed mergers, of which five were either referred to the CC (three) or subject to undertakings in lieu (one).

22 The parties considered that their actions were compliant with the undertakings provided.

23 Mr Blyde, the Managing Director of the target company prior to the merger, was appointed CEO of the merged business. At the time of the reference, the parties were continuing with integration, including making key employees redundant, integrating IT and accounting systems, and changing the way the combined assets were used.

24 The CAT noted at para.130 that, "since the outcome of a reference may well require a remedy to restore the status quo ante . . . , when exercising its powers under section 81 the [CC] may properly have regard to the need to safeguard the effectiveness of any divestiture that may ultimately be ordered . . .".

25 The relevant context from the CAT's perspective also included: that integration was "in full swing" on referral; that the merged business was being overseen by "one directing mind" who was formerly the CEO of the acquired business; that the parties had been on notice from at least the day after completion that the OFT might investigate the transaction and, given the parties' high combined shares, might ultimately refer it to the CC; and that the applicants took a substantial risk in pressing ahead with integration during the OFT's review and after agreeing initial undertakings with the OFT.

26 *Stericycle*, at [132]–[133]. The CAT explained that, although the parties undertook to the OFT not to take any action aimed at further integration or which might hamper competition between the parties on the relevant markets, there was an exception for action that had been initiated at the date of the initial undertakings. Moreover, while the undertakings had been signed and accepted, the applicants had stated in the covering letter enclosing the undertakings that, owing to the existing level of integration, they made, "no representations that the substance of the undertakings can be complied with" and in earlier correspondence declared that certain obligations contained in the undertakings had no content at all.

27 In *Park Group/Home Farm Hampers*, OFT decision of August 23, 2007, the OFT considered that initial undertakings would not be appropriate since the acquisition of a Christmas hamper savings scheme did not involve the transfer of physical assets or employees and the target's customer/agent list had been merged into the acquirer's database prior to the OFT's review.

28 In his lecture, "A Wise Man Proportions His Beliefs to the Evidence: Scepticism and Competition Policy" at a meeting of the David Hume Institute in the Royal Society of Edinburgh on May 3, 2007, Peter Freeman, Chairman of the CC commented that, "[o]ne way of avoiding [the problem of hold-separate measures] would be to move to a system of compulsory pre-notification of mergers—but I am not sure that business would welcome that at this stage, even though it is how almost every other country operates. But a consequence of having a voluntary system is that

Test for reference

The OFT is consulting on revised guidance on the criteria it will apply when deciding not to make a reference because the markets involved are not of sufficient importance to justify a reference pursuant to s.33(2)(a) of the EA 2002.[29] The OFT proposes to raise the current market size threshold of £400,000 to £10 million, although there will be a number of caveats under the new regime.[30] In a number of cases between January 2006 and August 2007, parties have unsuccessfully argued that the markets were of insufficient importance.[31]

In an appeal against an OFT conditional clearance decision,[32] the appellant Celesio argued with respect to the test for reference in s.33 of the EA 2002[33] that the OFT is always obliged to refer a merger to the CC where there is a greater than fanciful prospect of a substantial lessening of competition. The CAT not surprisingly disagreed, noting that above the fanciful the OFT has to form a judgment as to the point at which it comes to believe that it is or may be the case that a merger may be expected to result in an SLC.[34]

from time to time we have to unscramble completed mergers or joint ventures."

29 See Consultation on proposed revision to *Mergers—Substantive assessment guidance, Exception to the duty to refer: markets of insufficient importance*, dated June 2007.

30 In particular, the OFT will less likely make use of the exception where: (1) very concentrated markets are subject to low entry prospects and substantial consumer harm is likely; (2) there is evidence of existing co-ordination; (3) a reference would have important precedent value; or (4) vulnerable consumers will suffer a substantial proportion of the likely detriment.

31 See, e.g. *Hampden Agencies/Christie Brockbank Shipton*, OFT decision of July 14, 2006; and *Tetra Laval/Carlisle Process Systems*, OFT decision of July 20, 2006.

32 *Celesio AG v Office of Fair Trading (Celesio)* [2006] CAT 9.

33 The OFT has a duty to refer a merger if it believes that it is or may be the case that the relevant merger has resulted or may be expected to result in a substantial lessening of competition within any market in the United Kingdom.

34 As stated by the Vice-Chancellor in the Court of Appeal judgment in *Office of Fair Trading v IBA Health* [2004] EWCA Civ 142 at [48]: "it is clear that the words 'may be the case' exclude the purely fanciful because OFT acting reasonably is not going to believe that the fanciful may be the case. In between the fanciful and a degree of likelihood less than 50 per cent there is a wide margin in which OFT is required to exercise its judgment. I do not consider that it is possible or appropriate to attempt any more exact mathematical formulation of the degree of likelihood which OFT acting reasonably must require." The CAT reiterated the point it made in its judgment in *UniChem v Office of Fair Trading* [2005] CAT 8 at [172], namely, that the Vice-Chancellor, "was not implying that the OFT had a wide discretion, only that the degree of likelihood of a SLC will vary widely depending on the circumstances."

OFT's reasoning in decisions and evidential issues

Although the OFT had been producing detailed written decisions explaining the reasons for its decisions, the CAT has put the OFT on notice that its decisions must be even more thorough in their reasoning. At the same time, the OFT has continued to conduct extensive and detailed investigations, insisting on credible evidence to substantiate arguments advanced by merger parties or complainants. The OFT also places a certain degree of reliance on internal documents whether belonging to merging parties or third parties particularly where third parties' complaints are speculative in nature. While the OFT is obliged to consult competitors especially on factual matters relating to them, it recognises that they may have self-serving aims in bringing complaints.[35]

In the costs judgment in *Celesio*[36]— the main appeal related to the unsuccessful appeal by Celesio of the OFT's February 6, 2006 decision not to refer the acquisition by Unichem of Boots to the CC subject to suitable undertakings—the CAT decided on balance that it would not be just and appropriate to award the OFT its costs. Celesio's principal ground of appeal in the main case had been that the reasons given in the OFT's decision were not capable of sustaining the OFT's conclusion that a reduction from four to three fascia in local retail pharmacy markets would not give rise to a substantial lessening of competition. In the costs judgment, the CAT reiterated that the OFT's decision was unclear as to what evidence the OFT had relied upon in deciding that competition concerns did not arise with respect to those locations where three or more fascias remained post-transaction. The CAT said that:

> "[A] significant feature of the present case and of our discretion as to costs is that the reasons contained in the

35 See, e.g. *Verint Systems/Witness Systems*, OFT decision of May 23, 2007, where a single competitor complained to the OFT about the transaction which combined two of the three main players in interaction management software. The OFT explained that, "[a]ll customers were unconcerned, which is particularly probative as it is customers that would bear the brunt of any adverse merger effects on price, innovation or quality. On the contrary, many respondents, especially customers, commented that they expect the parties to be able to offer a more attractive product portfolio post-merger, which may have motivated the complaining third party. As that complainant is a horizontal competitor, it is unclear that alleged price increases or reduction in innovation or service quality would be detrimental to its interests. Conversely, the threat of a more effective competitor would prompt understandable fear of greater competition."

36 [2006] CAT 20.

> Decision were capable of sustaining the OFT's conclusion only by reading them carefully in the context of the elucidation provided in the witness statement [of the OFT's Director of Mergers] and having regard to the submissions of the OFT as to these issues at the hearing."

The CAT disagreed with the OFT's submission that it would be "unworkable if the sort of account provided in [the Director of Merger's] statement were required in its decisions."[37] This judgment clearly places a renewed emphasis on fully reasoned decisions and appears already to be leading to lengthier decisions on the OFT's part.

Safenet Inc/nCipher Plc provides an example of a case where the merging parties were not able to substantiate their submissions with adequate evidence.[38] The OFT concluded that the transaction would lead to a substantial lessening of competition in the market for hardware security modules where the parties accounted for 40 to 60 per cent of the overall sector on a global level and 70 to 90 per cent of such modules for public key infrastructure—the parties' UK turnover amounted to only £7.5 million and the target's global turnover was £17.4 million. While the parties advanced a number of arguments (including that their shares fluctuated over time, there were other credible bidders, and the parties would post-transaction be constrained by the expansion of existing and new competitors), they were not able to provide any evidence substantiating these arguments. The transaction was abandoned following referral. Equally, in *Compagnie Générale de Geophysique/Veritas*, third parties were not able to substantiate their vertical concerns that the merged entity might foreclose access to its seismic data acquisition equipment. The OFT noted that:

> "[O]n request by the OFT, concerned third parties were neither able to provide documentary evidence supporting their concerns (as may be expected if the merger was anticipated to have a potentially large impact on their seismic data acquisition operations) nor to provide evidence to suggest that any incentive for CGG to foreclose third parties is created or strengthened by the merger."[39]

The importance of internal documents can be seen, for example, in *Flybe Group Ltd/BA Connect* where internal documents prepared early in Flybe's assessment of a possible acquisition of BA Connect discussing the "competition upside" and "route rationalisation" belied the parties' arguments that the merged entity would be constrained by direct competition, competition from neighbouring airports, alternative transport modes, and low entry barriers.[40] In *Illovo Sugar/ABF Overseas*, one third party raised vertical concerns to the effect that it would lose a key source of direct consumption of sugar supplies from the most important future player among those from the Least Developed Countries. The OFT noted, however, that the:

> "third party's internal documents—which are particularly important in this case because of the speculative nature of the concerns—suggested that the third party would be inconvenienced, but not foreclosed, without access to Illovo. In addition, nothing in the documents presented by the merging parties to the OFT suggested that foreclosing competitors' access to refined sugar formed a rationale for the transaction."[41]

Failing firm defence

It is notoriously hard for merging parties successfully to argue the failing firm defence particularly at first phase

37 The CAT noted that, "[a]n interested party should be able to know the justification for the decision and to be able to assess whether they have any ground for challenging an adverse decision from the decision itself. It should not be necessary for the OFT to provide, for these purposes, any elucidation of the decision."

38 OFT decision of March 30, 2006.

39 OFT decision of February 6, 2007. In *Montauban/Simon Group*, OFT decision of August 2, 2006, third parties raised vertical concerns arising from the combination of a port owner in the Humber Estuary and one of its shipping customers. The OFT explained that the, "conclusion may have been different . . . had better evidence, including documentary evidence, been provided by concerned third parties to support their allegations." In *Johnston Press/Local Press*, OFT decision of May 5, 2006, advertisers submitted complaints to the OFT as regards the effects of the merger on local newspaper advertising in the Derry area where the parties' market share might be as high as 80%. However, since the advertisers did not provide evidence of switching between the parties' two titles, the OFT considered that it could not form a positive belief as to this theory of harm as opposed to a mere suspicion.

40 OFT decision of February 7, 2007. See also *Woolworths/Bertram*, OFT decision of April 3, 2007 (parties' internal documents provided ammunition for the OFT on a number of key issues); *Stagecoach Bus/Braddell*, OFT decision of March 15, 2006 (CityLink's internal documents highlighted the degree of pre-transaction competition among the parties, including CityLink's close monitoring of Stagecoach's operations and responding to price changes, as well as Stagecoach's significant impact on CityLink's profitability); and *Vue Entertainment Holdings (UK)/A3 Cinema*, CC decision of February 24, 2006 (Vue's internal assessment of the transaction explained that it provided Vue with an opportunity to dispose of its non-stadium seating first generation multiplex cinema in the overlap town of Basingstoke).

41 OFT decision of July 31, 2006.

and this has been confirmed in a number of cases. In *Thermo Electron Manufacturing/GV Instruments*,[42] the OFT emphasised the high level of supporting evidence required for this defence to succeed, explaining that it is difficult to verify such claims independently within the constraints of first phase review. While the merging parties in this case provided sufficient evidence to show that the target's financial difficulties were such that it would have exited the market absent the merger and that the target could not have obtained a sufficient cash injection for purposes of re-organisation, the OFT was not persuaded that no other realistic purchaser existed or that the target's assets might have been acquired out of liquidation to compete in the relevant markets.[43]

The parties argued in *Flybe Group/BA Connect* that BA Connect's financial data and internal business plan showed that it would not renew expiring leases on a number of aircraft in 2007, thereby giving BA Connect the chance to withdraw from its most unprofitable routes, including many of the overlap routes. Interestingly, the parties submitted that, although not a failing firm defence in the strict sense, this imminent change to prevailing conditions of competition must nevertheless be taken into account when considering the appropriate counterfactual. The OFT was not persuaded that this was not a failing firm defence and, in any event, explained that there is a high evidential standard that was not met in this case.[44]

In *Hampden Agencies/Christie Brockbank Shipton*,[45] which reduced the number of Members' agents at Lloyd's from three to two, the parties unsuccessfully maintained before the OFT that the target's exit from the market for Members' agency services at Lloyd's was inevitable since the market was unable to sustain more than two players. While the CC agreed with the OFT that the target was profitable at the time of the merger and therefore not a failing firm, it nevertheless found that the correct counterfactual was sale to Hampden Agencies in any event. This was because, owing to severe financial difficulties, the target's parent company would have gone bankrupt without sale of the target, and Hampden Agencies was the most likely purchaser (even if the parent company had gone bankrupt).[46] Also, in *Stagecoach/Scottish Citylink*, although the CC did not accept the failing firm defence with respect to the businesses being contributed to the JV, it did conclude that no competition concerns arose on the Glasgow/Edinburgh route given that the financial state of Stagecoach's services meant that it would have withdrawn its services leaving CityLink to expand its services reflecting the strength of its brand on its route.[47]

Relationship with Chapter I and II prohibitions

Two cases during the period under review have in different ways raised the issue of the relationship between merger control and the Ch.I and Ch.II prohibitions. First, in *Dairy Crest Group/Arla Foods UK*,[48] the OFT considered whether Dairy Crest's acquisition of Arla's doorstep and depot-based middle ground milk business, together with its acquisition in October 2005 of Arla's Express Foodservice Business in London,[49] raised co-ordinated effects concerns with respect to the supply of milk to middle ground

42 OFT decision of December 15, 2006.

43 The failing firm defence also failed in *Stagecoach Bus/Braddell*, OFT decision of March 15, 2006 (the parties' arguments that competition was not sustainable and that one of the parties would have exited intercity coach services in Scotland were contradicted by various evidence including internal CityLink documents setting out potential strategies such as "stay and fight" and/or "sit tight and contain"). See also *Kemira/Terra Industries*, OFT decision of January 26, 2007.

44 OFT decision of February 7, 2007. See also *SvitzerWijsmuller/Adsteam Marine*, OFT decision of August 31, 2006 (without advancing the failing firm defence, the parties unsuccessfully argued that Liverpool could sustain only one supplier of harbour towage services); and *Magicalia Publishing/Good Woodworking*, OFT decision of March 16, 2007 (the parties unsuccessfully argued that the *Good Woodworking* magazine would have been closed absent the transaction—again, while the parties advanced that this was not a failing firm defence, the OFT judged the argument according to the failing firm defence principles).

45 OFT decision of July 14, 2006.

46 On reference, the CC considered that sale to the other remaining Members' agent would not have had a materially different competitive outcome.

47 CC decisions of October 23, 2006. See also *Railway Investments/Marcroft*, CC decision of September 12, 2006. In this case, the CC found that EWS, the parent of Railway Investments, might raise prices or reduce the quality of its wagon maintenance services (both those provided at its Stoke depot and those provided in-field through its outstations) so as to harm its competitors in the downstream market for rail freight haulage services. In light of the financial difficulties facing Marcroft's Stoke depot, which was significantly underutilised, the CC considered that the correct counterfactual was that this depot would have been sold to a purchaser who would have used it for purposes outside the relevant market, thereby avoiding competition concerns with respect to this part of Marcroft's activities.

48 OFT decision of October 26, 2006.

49 The OFT exercised its discretion under s.27(5) of the EA 2002 to treat the two acquisitions as occurring simultaneously on completion of the second transaction.

customers. At the time of the OFT's review, although the OFT had reached the view that there were reasonable grounds to suspect an infringement of Ch.I of the Competition Act 1998 in the milk sector in Wales and the North of England, the OFT focused on whether the transactions under review resulted in or may be expected to give rise to co-ordinated effects concerns, for example, "by making coordination more perfect, more durable, or more complete". On balance, the OFT found that the transactions did not give rise to co-ordinated effects concerns and perhaps even reduced the market participants' ability and incentive to co-ordinate.[50]

Secondly, in *Railway Investments/Marcroft Holdings*, [51] the CC was concerned that Marcroft post-transaction would exercise its market power in the market for wagon maintenance services to raise prices or reduce quality (delaying maintenance), thereby harming competitors of EWS (parent of the acquirer) in the market for rail freight haulage. The parties argued that, when assessing Marcroft's incentives to foreclose rivals, it is necessary to have regard to the fact that such conduct would likely breach Art.82 EC or the Ch.II prohibition.[52]

The CC considered that the extent of this deterrent effect depended on: (1) the likelihood the conduct would breach the relevant provisions; (2) the likelihood of successful enforcement action; and (3) the time frame of such enforcement action. The CC determined that there was sufficient uncertainty around the doctrine of excessive prices that this would not necessarily provide a disincentive. As to delaying maintenance, the CC considered that there was a significant risk that the conduct would not readily be ascertainable before the anticipated harm had occurred. The CC therefore rejected the parties' argument on the facts of this case.

OFT adopting robust stance

Notwithstanding the renewed pressure placed on the OFT to provide sufficient reasoning in its decisions, as well as the increased threat of challenge before the CAT, the OFT has shown that it is able to clear within first phase time constraints transactions involving high shares and/or vociferous complainants.

Unconditional OFT clearance decisions

The following are examples of such unconditional OFT clearance decisions:

- In *General Mills UK/Saxby Bros*,[53] although the parties accounted for over 80 per cent of ingredient pastry supply to retailers in the United Kingdom (with an increment of 25 to 35 per cent), the OFT found that the transaction did not raise concerns. This was because the parties were currently only potential competitors (General Mills was active only in the sale of frozen pastry and Saxbys only in the sale of chilled pastry),[54] entry barriers were relatively low, retailers could switch to own-label ingredient pastry supply to the extent that branding constituted a barrier, there was sufficient capacity in the hands of third parties, and supermarkets and other large suppliers have significant buyer power.
- The parties in *Minova UK/Exchem* accounted for 100 per cent of UK sales of resin capsules used for anchoring steel bolts that attach reinforcements to rock and concrete surfaces in tunnels and underground roadways. The OFT considered that the transaction would not have an adverse effect

50 The OFT had no evidence of collusion with respect to the overlap areas (the Midlands and London). It was unlikely that the transaction would give rise to co-ordinated effects concerns in non-overlap areas such as the North of England as Dairy Crest was not an important potential entrant in the areas possibly affected by collusion, and asymmetries would increase vis-à-vis local education authority customers since Arla had exited the direct supply of milk in overlap areas but remained a potential indirect supplier. It was also arguable that the transaction replaced a market participant (Arla) against whom there was evidence of collusion with one against whom there was no such evidence (Dairy Crest).

51 CC decision of September 12, 2006.

52 For consideration of these issues under EC merger control law, see Case T-210/01, *General Electric v Commission* [2005] E.C.R. II-5575; and Case T-5/02, *Tetra Laval BV v Commission* [2002] E.C.R. II-4381; and Case C-12/03 P, *Commission v Tetra Laval BV* [2005] E.C.R. I-987.

53 OFT decision of November 27, 2006.

54 The parties provided price correlation data and other econometric studies to support their arguments that chilled and frozen pastry belonged to different product markets. While the price correlation data showed that price changes in one product had minimal impact on volumes sold of the other product, the OFT considered that data also evidenced price correlation between them. Moreover, although own-price elasticities for each product were negative, there were some statistically significant positive cross-price elasticities, especially from frozen to chilled pastry (suggesting that frozen pastry customers would switch to chilled pastry in the face of a price increase). The evidence from consumers on demand-side substitution was mixed with evidence of at least some substitutability between the two—chilled pastry appeared to be a stronger demand constraint on frozen pastry than vice versa. From the supply perspective, the OFT found that the basic production process for chilled and frozen pastry was precisely the same, although there were differences in frequency of production and storage/distribution.

on UK customers since Minova had only a single supply contract in the United Kingdom, which it supplied from Poland and, absent its own distribution network in the United Kingdom, it was not commercially feasible for Minova to have acted as a competitive constraint on Exchem with respect to the remaining UK customers.[55]

- In *Lord Corporation/Henkel KgaA*,[56] the parties accounted for 70 to 80 per cent of UK sales of bonding agents for bonding rubber to substrates and 50 to 60 per cent of European sales. The OFT considered that the transaction did not raise concern as the customer base is highly concentrated, customers tend to be "tier 2" suppliers to the automotive industry, which are themselves subject to significant pricing pressure from automotive manufacturers, and competition occurs at the design or development stage with sufficient alternative suppliers to the merged entity.
- Notwithstanding that the OFT considered that prices might increase in the short term, the OFT found in *Acetate Products/Celanese*[57] that the reduction of four to three principal trans-Atlantic suppliers of cellulose acetate tow to the tobacco industry (with the parties accounting for 40 to 50 per cent of capacity) would not lead to a substantial lessening of competition. There had been a sharp fall in demand for cigarettes in the United Kingdom and western Europe in recent years, which had resulted in the major tobacco companies shifting their production to Asia. While trans-Atlantic tow suppliers were currently capacity constrained, they had been following the tobacco manufacturers to Asia and investing in capacity there. Moreover, cigarette manufacturers operate global sourcing strategies and can be expected to adjust these strategies in the face of attempted price increases post-transaction. The OFT considered that tobacco manufacturers could in particular turn to Daciel, a Japanese importer, to replicate the competitive constraint that Acetate Products Ltd had imposed on Celanese and other trans-Atlantic competitors.
- Although the parties accounted for 60 to 70 per cent of prepared gravies and stock in the United Kingdom and had the two strongest brands (OXO and Bisto), the OFT in *Premier Foods/RHM*[58] was not concerned particularly given that the parties were not each other's closest competitors owing to significant product differentiation and since supermarkets' own-label offerings provided the strongest competitive constraint on Bisto's sales of prepared gravies and Knorr on OXO's sales of stock cubes.
- In *Autoglass/Nationwide Autoglazing*,[59] the OFT cleared the transaction notwithstanding that the parties accounted for 40 to 50 per cent of the supply of repair or replacement vehicle glass services given strong countervailing buyer power in the hands of insurers who settle over 80 per cent of all vehicle glass fixing claims and refer their insureds to particular repairers under preferred supplier arrangements that are renewed every one to three years. The OFT also considered that the transaction would reduce entry barriers since Autoglass intended to close down Nationwide's facilities, which would then become available to competitors.[60]
- A number of cases have also been found unproblematic in light of the small share increment. In *Brenntag UK Holdings/Albion Group*, for example, the OFT cleared a transaction involving high shares in certain specialty chemicals in the United Kingdom not least given the *de minimis* increment.[61]

55 OFT decision of January 30, 2006. The OFT also considered that the geographic market was at least as wide as Europe (where the parties accounted for 80–90% of sales) and might be broader.
56 OFT decision of May 26, 2006.
57 OFT decision of November 8, 2006.
58 OFT decision of February 5, 2007.
59 OFT decision of January 25, 2006.
60 See also *British United Provident Association/ANS*, OFT decision of January 10, 2006 (although the parties accounted for over 50% of nursing homes on a local basis, care homes were characterised by low levels of concentration on a national basis; new entry, most likely from established care home groups and perhaps sponsored by local funding authorities, would provide a sufficient competitive constraint; and local funding authorities, which pay around two-thirds of all care fees, have countervailing buying power); *Keystone Lintels/IG Lintels*, OFT decision of November 7, 2006 (relatively high shares in steel lintels offset by significant spare capacity among competitors and low entry barriers); *Balfour Beatty/Edgar Allen*, OFT decision of July 6, 2006 (UK shares of railway track turnouts of 65–75% (with a 30–35% increment) did not raise concern since shares of supply can change significantly year on year; expansion by existing UK competitors posed sufficient competitive constraints; and Network Rail had countervailing buyer power).
61 OFT decision of November 28, 2006. See also *Panavision Europe/AFM Group*, OFT decision of February 1, 2007 (combination of two of the three largest suppliers of rental lighting equipment to broadcast customers, but with small increment and strong countervailing buyer power in the case of the large film studios); *BT Group/PlusNet*, OFT decision of January 23, 2007 (0–5% increment to BT's share of UK fixed lines of 74.4%); *Capita Financial/Sinclair Henderson*

Conditional OFT clearance decisions

The following are examples of conditional OFT clearance decisions:

- In *Boots Group/UniChem*,[62] the merger combined 1,423 UK pharmacies belonging to Boots with 958 belonging to UniChem. While dismissing various vertical concerns raised by third parties, the OFT undertook a detailed horizontal analysis and determined that the test for referral was satisfied in relation to those locations where there was a reduction in competing pharmacies (fascias) from two to one and three to two in a one-mile radius around the parties' pharmacies—this covered 96 areas. To obtain clearance at phase one, the parties committed to divest one of the parties' stores in each of those overlapping areas. They also agreed to sell the stores in packages to address the OFT's concerns as regards the practicability of assessing and consenting to such a large number of individual disposals.[63]
- In *Aggregate Industries/Foster Yeoman*,[64] the OFT was concerned that the completed transaction raised co-ordinated effects concerns in the supply of asphalt in the Hertford area with Aggregate Industries and Lafarge accounting for almost 90 per cent of sales post-transaction and Aggregate Industries having replaced Foster Yeoman as shareholder in Harlow Coated Stone, a joint venture with Lafarge operating in this area. In lieu of reference, notwithstanding that Foster Yeoman also had minor activities in the Hertford area outside Harlow Coated Stone, the OFT accepted as sufficient an offer by Aggregate Industries to divest its shareholding in Harlow Coated Stone, thereby severing the structural link with Lafarge.

Referral decisions

There have been a number of interesting referral decisions during the period under review both with respect to unilateral, multilateral, and co-ordinated effects.

Unilateral and multilateral effects

In *Stonegate Farmers/Deans Food*,[65] the OFT referred to the CC the completed merger between two suppliers of shell eggs and processed eggs (which were predominantly sourced from third party producers) in light of the high combined UK shares in shell eggs (the parties accounted for 60 per cent of shell eggs to retailers) and liquid egg (the parties accounted for around 50 per cent or more), combined with the lack of sufficient countervailing buyer power and the fact that there would not be sufficient timely expansion by competitors. On reference, the CC found that the transaction would give rise to a substantial lessening of competition through unilateral and multilateral effects[66] with respect to the supply of shell eggs to retailers. The CC also found that the transaction raised concerns with respect to the buying power of the merged entity, which would ultimately lead to lower output as a result of the merged entity insisting on lower purchase prices, bundling purchases with sales of inputs such as animal feed, and/or negotiating less favourable contracts as regards non-price terms. While the CC in its provisional findings concluded that there were also concerns as regards liquid eggs, it found that customers' threatening

Companies, OFT decision of October 24, 2006 (60–70% of UK hosting services to open ended funds, but with *de minimis* increment); *ABF Holdings/Primary Diets*, OFT decision of August 30, 2006 (relatively high shares for monogastric compound animal feed, but with *de minimis* increment); and *Getty Images/Digital Vision*, OFT decision of February 17, 2006) high shares in the supply stock photographs from photo libraries, but with *de minimis* increment and evidence that the target was not a significant competitor).

62 OFT decision of February 6, 2006.

63 The OFT also conducted a thorough local analysis in *Cooperative Group (CWS)/Fairways Group UK*, OFT decision of November 29, 2006, relating to funeral directing services. The OFT did not consider that a fascia approach was suitable since this would capture neither the important reputational aspect of competition in this product area (and therefore the strength of the parties' competitors) nor the fact that funeral businesses often trade under the original name even when part of a large group (and consumers are therefore unlikely to be aware of whether another funeral business is part of the same fascia). The OFT therefore relied on share data showing shares of funerals and found that the transaction would give rise to a substantial lessening of competition in five local areas. To address the OFT's concerns, the parties agreed to divest 13 funeral businesses in the five areas.

64 OFT decision of November 20, 2006.

65 OFT decision of September 13, 2006.

66 The CC concluded that it would be in the interests of smaller shell egg suppliers, particularly given their difficulty in acquiring eggs in the short term, to follow a price increase by the merged entity rather than maintain or reduce their prices to increase market share. Such multilateral effects do not require any form of co-ordinated behaviour, but could emerge purely from the actions of the suppliers in the market responding to one another's prices.

to switch to imported liquid eggs or other UK suppliers would act as a sufficient constraint on the merged entity. The CC ultimately determined that the most effective remedy was to unwind the transaction through the divestiture of the smaller of the two companies Stonegate Farmers.

The OFT in *Woolworths/Bertram*[67] referred the completed acquisition of Bertram to the CC after revisiting many of the issues (including market definition) that had been considered in the recent acquisition of AMP by Woolworths.[68] In the earlier case, the OFT had considered that the appropriate frame of reference was the supply of books through both wholesalers and direct supply by retailers. In the current case, the OFT nevertheless determined that the appropriate frame of reference was the wholesale supply of books to independent retailers, finding that the transaction led to a reduction from three to two book wholesalers on this market.[69]

A number of transactions raising unilateral effects concerns were abandoned following reference to the CC. The OFT concluded in *IPC Media/Horse Deals*,[70] for example, that the transaction brought together the two closest rival horse magazines (*Horse and Hound* and *Horse Deals*) particularly with respect to the advertising of horses for sale. The OFT was given evidence during the course of its inquiry showing that competition between these two titles had resulted in lower prices and/or better quality service and that IPC had regarded *Horse Deals* as providing significant competition to which it responded. The OFT also did not consider that new entry would be timely or sufficient to counteract the elimination of demonstrable close competition between the parties. In *MacDonald, Dettwiler and Associates/Quest End Computer Services*,[71] the OFT referred the transaction having found that the parties were the only two recognised providers in the market for automated property valuation network services (connecting, for example, mortgage lenders with valuers) and each other's closest competitor. In addition, network externalities were important, barriers to entry were high, and there was insufficient countervailing buyer power.[72]

Co-ordinated effects

In *Wienerberger Finance Service/Baggeridge Brick*,[73] the proposed transaction would result in three main suppliers accounting for 85 per cent of clay brick supply in the United Kingdom, each with shares of supply and national coverage far exceeding their nearest competitors (the merged entity would account for 20 to 30 per cent, Hanson for 30 to 40 per cent, and Ibstock for 30 to 40 per cent). Notwithstanding credible arguments from the merging parties that market participants would lack an incentive to co-ordinate,[74] the OFT considered that there were a sufficient number of risk factors present in this case to warrant a reference (including a material degree of product homogeneity; relatively long-term and transparent demand trends; a credible punishment mechanism in the form of large stockpiles and significant spare capacity; high entry barriers; and an insufficiently large competitive fringe). The OFT emphasised that a simple checklist approach to co-ordinated effects was not sufficient for a reference, but that:

> "[T]he OFT would, at a minimum, wish to be able to describe a non-fanciful mechanism for coordination before taking a reference decision."

While dismissing the notion that the market participants might co-ordinate around capacity, the OFT could not rule out that they might be able to co-ordinate around price.[75] The OFT also confirmed that it will generally be

67 OFT decision of April 3, 2007.

68 *Woolworths/AMP Enterprises*, OFT decision of December 15, 2006.

69 In *FirstGroup/Greater Western*, CC decision of March 8, 2006, the CC adopted an analytical approach similar to that used in previous cases involving rail and bus services, but adapted it to the circumstances of the current case, "which [were] in some respects significantly different".

70 OFT decision of August 16, 2006.

71 OFT decision of February 14, 2007.

72 See also *G4S Cash Services (UK)/Abbotshurst Group*, OFT decision of May 18, 2007 (OFT referred the transaction, which was conditioned on OFT merger clearance, in light of the parties' overlap in the supply of cash-in-transit services on a regional basis); and *Polypipe Building Products/Verplas*, OFT decision of July 11, 2007 (reduction from three to two UK manufacturers of domestic ventilation products).

73 OFT decision of December 11, 2006.

74 The parties' arguments included the fact that there were asymmetries between the clay brick suppliers with respect to market size, product portfolios, spare capacities, and marginal costs, and the fact that demand was not stable.

75 The parties provided price dispersion data in an attempt to show that prices charged for bricks are widely dispersed with substantially different prices being charged to different customers for similar quantities. The OFT did not find the evidence sufficiently compelling not least as there was much less variation in prices for very large orders, the data submitted by Baggeridge was more limited than that submitted by Wienerberger, and the OFT was not provided with such data for Hanson and

reluctant to refer a transaction based on a theory of harm on explicit co-ordination without some evidence, for example: (1) that there was pre-existing explicit contact between market participants; (2) that the transaction creates a structural forum for contact between the market participants; or (3) that the incentives for explicit co-ordination have significantly increased. After an in-depth investigation, the CC ultimately found that the transaction did not give rise to co-ordinated effects concern.[76]

Remedies

In the period under review, the CAT handed down two judgments that have clarified certain substantive issues vis-à-vis merger remedies. The decisions of the OFT and the CC themselves also indicate that these authorities are becoming more strict with respect to the composition and implementation of merger remedies.

Restoring the status quo and the regulators' margin of appreciation

Two CAT judgments have clarified that the OFT and the CC are entitled to take the status quo as the starting point when determining the appropriate remedies and that the authorities have a wide margin of appreciation in deciding whether to accept particular remedies or proposed purchasers.

In *Co-operative Group (CWS) Ltd v Office of Fair Trading (Co-operative)*,[77] Co-operative challenged a decision by the OFT not to approve Southern as proposed purchaser of funeral businesses that Co-operative had committed to divest to obtain OFT clearance of its acquisition of Fairways. The OFT rejected Southern as proposed purchaser on the ground that the existence of an interlocking directorship between Southern and Co-operative meant that Southern did not satisfy the test of independence set out in the undertakings in lieu. The OFT was concerned that the interlocking directorship might reduce the level of post-divestiture competition not least through the flow of sensitive information. While accepting that it was legitimate to construe the undertakings taking into account the purpose of the undertakings under s.73 of the EA 2002, the CAT found that the OFT acted within its margin of appreciation in deciding to reject Southern as the proposed purchaser. The CAT also considered that the OFT was entitled in the context of implementation of the undertakings to take as the starting point the objective of restoring competition to pre-merger levels—this would not deny a divesting party the possibility to satisfy the OFT (without requiring a detailed investigation)[78] that the proposed remedy clearly and comprehensively removes the SLC without restoring competition to the pre-merger levels.[79] The CAT also held that the OFT was entitled to reject Co-operative's proposal to implement a firewall so as to prevent the flow of confidential information.

On announcement of the CAT's judgment in *Co-operative*, Simon Pritchard, now Senior Director of Mergers at the OFT, said:

Ibstock. Given the incomplete evidence, the OFT explained that its "general policy is to apply a lowered threshold of probability in determining whether its duty to make a reference . . . is met".

76 CC decision of May 10, 2007. The CC found that there was no evidence of co-ordination by the four firms over the previous five years; there was no risk of co-ordination in future not least as it would be difficult to identify focal points for co-ordination; and there were no incentives to co-ordinate given the absence of sufficient symmetry among the firms in operating costs and gross margins.

77 [2007] CAT 24.

78 The CAT also noted that, in line with the OFT's role as a first screen, the OFT is not "required, at the implementation stage, to conduct a detailed investigation as to whether a structural connection between a divesting party and a proposed purchaser would deliberately or inadvertently result in them being less effective competitors."

79 The OFT's preference for restoring pre-merger competition can be seen in a number of cases. In *Pan Fish/Marine Harvest*, OFT decision of July 6, 2006, for example, the parties did not persuade the OFT to accept a divestiture remedy that did not cover the entire overlap between the parties. The OFT concluded that the transaction satisfied the test for referral because it brought together the two largest producers of salmon in the EEA, who were each other's closest competitors and accounted for at least 25–35% of EEA Atlantic salmon sales. It was not clear to the OFT that competitors, who were significantly smaller than the merged entity, could increase output in the short or long term. The OFT also considered that the parties could identify and price discriminate against a sub-set of customers who placed a premium on Scottish salmon—the parties accounted for at least 43% of Scottish salmon EEA sales. To resolve these concerns, the parties offered divestitures with the effect of reducing the parties' Scottish salmon production to the pre-merger level. The OFT, however, did not consider that the proposed remedy sufficiently reduced the parties' salmon production at the EEA-wide level, representing around 0–5% of the parties' production. See also *Stericycle International LLC/Sterile Technologies Group Limited,* OFT decision of June 28, 2006 (the OFT rejected a proposed divestiture remedy since it would remove only around half of the share increment in high temperature treatment of medical risk waste and it was unclear whether sale to one of the smaller market participants would be able to recreate the pre-merger competitive position where two major players had been in active competition on a regional and national level).

> "Where possible, the OFT prefers remedies that completely undo the harm threatened by a merger by restoring competition to pre-merger levels. In a case like this, we investigated, found problems, and intervened to solve them. As a general policy, it makes little sense to incur the costs of intervention and then ultimately settle for less competition than before the merger. That is why restoring competition reflects international best practice."[80]

The CAT's judgment in *Somerfield Plc v Competition Commission* raised similar issues with respect to remedies before the CC.[81] Somerfield unsuccessfully challenged the CC's requirement that it sell the target's supermarkets, rather than its own, in the areas of overlap raising competition concern. The CAT, having remarked that the CC has a clear margin of appreciation to decide the appropriate remedial action, disagreed with Somerfield that, absent exceptional circumstances, the acquirer should be left the choice as to whether to divest its own or the target's store on the basis that both remedies would restore the status quo ante. Rather, the CAT concurred with the CC that it is legitimate to take as the starting point that the status quo ante will be restored by divestiture of the acquired store, while being open to the acquirer to demonstrate to the CC's satisfaction that disposal of an existing store would equally address the competition concern.[82] Although divestiture of a store belonging to the acquirer might remedy the substantial lessening of competition, this may not always be the case, for example where the acquirer's store is less attractive to potential purchasers. The acquirer should have the onus of providing evidence to satisfy the CC that this starting point is displaced by the relevant circumstances.[83]

Trade-off between offering Phase I remedies and avoiding Phase II

As with EU merger control, merging parties may find it necessary to offer remedies to obtain first-phase clearance where in-depth investigation would have determined that no remedies were required. This is inherent in the different tests as between first-phase and second-phase at UK (and EU) level,[84] as well as the fact that there is significantly less time to review mergers at first phase. From the CAT's judgment in *Celesio*,[85] it is apparent that the merging parties, with a view to obtaining first-phase clearance, had offered remedies with respect to three-to-two fascia overlap areas the majority of which the OFT did not think raised concerns. This was because the OFT had not been able within its statutory timetable to develop a sufficiently robust principle to distinguish between a minority of three-to-two fascia areas that were marginally problematic and satisfied the reference test, and the remainder that raised no concern. The OFT had therefore concluded that its duty to refer extended to all three-to-two fascia areas. As the OFT's Director of Mergers explained to the CAT:

> "[W]e were aware that, depending on the undertakings in lieu proposals, that this might compel a reference in respect of areas where none was necessary, or result in divestments where none was really necessary. Nevertheless, this issue is consistent with our first-phase role in UK merger control, despite the extensive investigation and experience applied to this particular case."

This highlights the trade-off between offering commitments to obtain clearance at the OFT stage and thereby avoiding an in-depth investigation, and not offering first-phase commitments in the hope that they will not ultimately be required but being subjected to an in-depth investigation.[86]

80 See OFT press release of July 30, 2007.
81 [2006] CAT 4.
82 It does appear, however, that the CC in the context of an in-depth review may be more willing to accept remedies falling short of restoring the status quo. In *Railway Investments/Marcroft*, CC decision of September 12, 2006, for example, the CC accepted a partial divestiture that would have left EWS (the parent of Railway Investments) with almost half of the target's business on the relevant market and meant that EWS would have a similar share of sales as the purchaser.
83 The CAT also noted that, for the CC to be justified in requiring divestiture of the target's store, it is sufficient if there is a real risk that sale of an existing store would be problematic without needing to show a risk that the sale would not proceed.
84 As discussed above, the test for reference to the CC under s.33(1) of the EA 2002 is satisfied where the OFT forms a belief that, "it may be the case" that the transaction may result in a substantial lessening of competition. The CC on the other hand under s.36 must decide whether the transaction may result in a substantial lessening of competition. At the EU level, the European Commission must initiate an in-depth investigation where the transaction raises serious doubts as to its compatibility with the Common Market. At the end of the second phase investigation, the European Commission must determine whether the concentration would significantly impede effective competition and therefore be incompatible with the Common Market.
85 [2006] CAT 9.
86 In *Pan Fish/Marine Harvest*, OFT decision of July 6, 2006, for example, the OFT rejected the parties' remedies offered in Phase I, but the transaction was ultimately cleared by the CC on reference. See CC decision of December 18, 2006.

Price controls not likely acceptable

While the UK competition authorities have perhaps historically been more receptive to behavioural undertakings (including price controls) as compared with other competition authorities around the world, this may be changing. In *National Express Group/Prism Rail*,[87] the OFT considered a request from National Express to review the behavioural undertakings accepted by the Secretary of State for Trade and Industry under s.75G of the Fair Trade Act 1973 in lieu of reference in 2000. To address concerns arising from the combination of the coach and rail service providers from central London to Stansted airport, National Express committed to cap its coach prices on this route at a level no higher than equivalent fares on its London/Heathrow coach service. There were important market developments, however, after the undertakings had been given. First, demand for travel to Stansted rose significantly relative to demand for transport to Heathrow. Secondly, National Express withdrew its dedicated London/Heathrow coach service owing to unprofitability. Absent the undertaking, National Express would have cut its prices by 50 per cent on the London/Heathrow route. In agreeing to the variation of the undertakings and deciding not to impose a replacement behavioural undertaking,[88] the OFT stated:

> "This review of undertakings has reinforced the importance of exercising caution in accepting behavioural undertakings that aim to remedy the loss of horizontal competition resulting from a merger by way of price controls. In this case, the undertakings appear to have had unforeseen consequences. One such consequence is that the undertakings appear to be harming consumers on a market not affected by the merger: consumers are currently being deprived of tickets from London to Heathrow at around 50 per cent of their current price."[89]

This position is also reflected in the CC's decisional practice. In *Hamsard 2786/Academy Music*,[90] for example, the CC concluded that the transaction would result in a loss of rivalry between five large concert venues owned by the parties in London. The parties initially proposed behavioural remedies to address the CC's concerns: (1) publication of rate cards for the five venues raising concern, based on prices no higher than those prevailing as at November 1, 2006 and covering all price components with permitted increases not to exceed the increase in the retail price index; and (2) a commitment to maintaining currently projected levels of investment. The CC rejected these remedies not least because behavioural remedies designed to address particular adverse effects will not address unforeseen effects. Also, since changes in the retail price index would not likely reflect changes in the costs of operating live music venues in London, the proposed remedy would provide an unnecessary competitive straightjacket. The CC was also not confident that competitive conditions would return, as argued by the merging parties, within the envisaged three-year period for the commitments.[91] The CC also rejected a further proposal that the parties would divest the relevant venues in three years time if effective competition had not been restored through market developments. Such a remedy, which would increase the costs of implementation, would be appropriate only where the CC was confident that market developments would restore effective competition.[92]

87 OFT decision of August 3, 2006.

88 The OFT rejected replacement undertakings for the following reasons. First, the OFT considered that the original remedy was relatively simple to monitor in as much as it provided an obvious comparator to the London/Stansted coach service. Any substitute mechanism would likely introduce more complex or invasive regulation of coach services, together with the requirement for additional OFT supervision. Secondly, a price control linked to the retail price index would not adequately reflect factors that drive competitive coach prices such as variable industry costs, passenger demand and the intensity of competition between operators. The OFT also noted that a new competitor had entered the market and that further entry was likely given the current margins and demand estimates for Stansted airport passenger traffic.

89 For other cases in which price controls have been rejected during the period under review, see, e.g. *Macquarie UK Broadcast Venture/National Grid Telecoms Investment*, OFT decision of August 8, 2007 (OFT rejected price regulation in managed transmission services provided to radio and television broadcasters); *Greif/Blagden Packaging*, OFT decision of February 20, 2007 (OFT rejected a price control undertaking in lieu of reference aimed at addressing concerns at the parties' overlap in steel drums); and *Stagecoach/Scottish Citylink*, CC decision of October 23, 2006 (CC rejected remedy involving fare regulation service level obligations notwithstanding that it preserved certain customer benefits and could be effective in addressing the competition concerns—the CC found that a divestiture remedy was preferable).

90 CC decision of January 23, 2007.

91 The CC has suggested elsewhere that price control might be appropriate to remedy short-term competition concerns. See, e.g. *Vue Entertainment Holdings (UK)/A3 Cinema*, CC decision of February 24, 2006.

92 See also *SvitzerWijsmuller/Adsteam Marine*, CC decision of February 9, 2007. With a view to resolving concerns in Liverpool harbour where the parties were the only providers of harbour towage services, the parties offered a price control mechanism linked to the retail price index for three years. Notwithstanding that most harbours had only a single provider of such services, the CC was concerned at the limited timescale of the remedy, as well as the inability of the proposed discount control mechanism

Outside the context of price control remedies, *Railway Investments/Marcroft* provides a good example of a case in which other types of behavioural undertakings were rejected by both the OFT[93] and CC.[94] The transaction combined the largest merchant provider of in-field rail freight wagon maintenance services (Marcroft) with the largest in-house provider of such services (EWS) in a highly concentrated market with high entry barriers. After the OFT had found that EWS was Marcroft's most credible potential competitor, EWS proposed three behavioural undertakings in lieu of reference. The OFT rejected the undertakings not least since their qualified nature meant that they were not clear-cut—the proposed remedy was that EWS would grant its competitors access to railway facilities and undertake ad hoc movements of rail freight wagons to assist them in providing in-field rail freight wagon maintenance services provided it had sufficient capacity available.[95] On referral, EWS again proposed behavioural commitments—this time to continue supplying rail freight haulage suppliers on open and non-discriminatory terms and to appoint independent non-executive members to Marcroft's board—to address the CC's concern that EWS might seek to undermine its competitors in the downstream market for rail freight haulage services by increasing the price of, or delaying, maintenance services. These behavioural commitments were also rejected not least since it was thought that damage, which could be inflicted in short order, could not then be remedied through enforcement action.[96]

While it is increasingly difficult to persuade the OFT to accept behavioural remedies, the OFT has suggested that it will give careful consideration even to behavioural remedies where the value of the problematic markets are small relative to the overall transaction size.[97]

Regulators becoming more strict

In addition to an increasing reluctance to accept behavioural remedies, there are signs that the OFT and the CC are perhaps becoming more strict vis-à-vis merger remedies in other respects:

- In *Tetra Laval/Carlisle Process Systems*,[98] the OFT apparently for the first time specified a particular purchaser before accepting the undertakings in lieu.[99] The OFT concluded that the test for referral was met in relation to the supply to UK

to adapt to different circumstances (for example, the different mixes of customers using the port). The CC therefore insisted on the divestiture of one of the parties' operations in Liverpool.

93 OFT decision of February 6, 2006.

94 CC decision of September 12, 2006.

95 The OFT also rejected behavioural remedies in lieu in *Stericycle International/Sterile Technologies,* OFT decision of June 28, 2006 (merged entity's price for any service where the OFT found a substantial lessening of competition would be displayed on its website and linked to the retail price index or a formula more closely related to industry costs).

96 In *Stonegate Farmers/Deans Food*, CC decision of April 20, 2007, the merged entity had offered behavioural remedies aimed at resolving concerns that the merged entity's competitors would not have sufficient access to supplies of shell eggs from those producers with which the merged entity contracted for its supplies. In particular, the merged entity offered to give those producers currently supplying Stonegate Farmers the opportunity to terminate their supply contract on three months' notice, thereby allowing them to supply other egg packers/processors and giving retailers a credible switching option. The parties argued that this would avoid the loss of the efficiencies arising from the merger and would require minimal monitoring. Third parties were nevertheless critical of the proposed remedy and the CC considered that it would involve considerable bureaucracy and not re-create a strong second alternative supplier to retailers. The CC rejected two further behavioural remedy proposals on this theme.

97 In *Kemira GrowHow/Terra Industries*, OFT decision of January 26, 2007, the parties established a JV combining their UK and Irish fertiliser businesses. The OFT determined that the transaction would give rise to a substantial lessening of competition in the markets for various process chemicals (60% concentration nitric acid, anhydrous ammonia, and aqueous ammonia) and ammonium nitrate for non-agricultural applications in relation to which the parties would account for 100% of UK production. There was no evidence to suggest that entry would constrain the parties. As these chemicals represented a small part of the proposed JV's business—the value of the three process chemicals UK businesses were each less than £5 million—the OFT gave careful consideration to the parties' proposed remedies. The parties offered to outsource Kemira GrowHow UK's nitric acid and ammonia supply activities in the UK and proposed the supply of ammonium nitrate for non-agricultural applications on objective terms and prices. The OFT considered that the first remedy might facilitate co-ordination between the JV and the purchaser since the JV would have access to the purchaser's input costs and output volumes, while a complex cost analysis would also be required to determine the initial transfer price. The OFT decided that the second remedy comprising a price cap would not be capable of restoring effective competition, and would not address the non-price aspects of competition on which customers place particular value in this sector.

98 OFT decision of July 20, 2006.

99 OFT decision of July 20, 2006. See the OFT's Annual Report and Resource Accounts 2006–2007. This case did not involve an upfront buyer solution in the sense of the parties' committing not to close the transaction under review until entering into binding agreements with a prospective purchaser—this is the typical upfront buyer solution used by the European Commission. See also *Railway Investments/Marcroft*, CC decision of September 12, 2006, where the parties found a buyer with respect to a partial divestiture remedy during the CC's investigation.

customers of cheese vats, cheddaring machines and cheese towers used in the industrial manufacture of cheddar cheese. To remedy the concerns, the parties offered an irrevocable exclusive EEA-wide licence to produce, market, sell and distribute all branded products sold by the target in the United Kingdom over the past 10 years—this extended to non-overlap products so as to minimise the risk of brand confusion. The OFT considered that it was necessary for the licence to be EEA-wide, rather than limited to the United Kingdom, as well as in perpetuity, so that the licensee could realise a sufficient return on investment in innovation and marketing. The OFT accepted that divestiture of the target's manufacturing facility would be disproportionate since only a certain part of that facility's capacity was used for the manufacture of the overlap products.

- The CC concluded in *Hamsard 2786/Academy Music Holdings*[100] that the transaction would result in a loss of rivalry between five large concert venues owned by the parties. To remedy this concern, the parties undertook to divest the Brixton Academy or the Hammersmith Apollo, plus either the SDE or the Forum. In light of concerns that the competitive capability of the divestiture package might deteriorate prior to divestiture through the loss of customers or management, the CC insisted on an upfront buyer solution meaning that the parties could not complete their transaction until the parties had entered into binding agreements with a suitable purchaser. The upfront buyer solution also reduced the risks associated with the fact that the venues for divestiture were not entirely standalone, but relied on their parents for the provision of services such as investment and financial planning, as well as IT and website management on central systems that could not be included in the divestiture package.
- In *Stericycle International and Sterile Technologies*, [101] to remedy concerns resulting from a reduction from two to one in the supply of high temperature treatment services for healthcare risk waste in parts of northern England, the north Midlands, and north Wales and a reduction from three to two in parts of north Wales, the west Midlands, and south-east Wales, the parties offered a partial divestiture of the target's business comprising incinerators at Salford, Redditch and Wrexham, together with: (1) a "put or pay" sub-contract guaranteeing up to 75 per cent of the divested capacity until 2009; (2) a long-term vendor financing package for up to 50 per cent of the purchase price; and (3) availability of a senior management team if required. While the CC raised a number of concerns with this proposed remedy,[102] it accepted the proposal noting that it would involve the least cost and intrusion having regard to the principle of proportionality. It nevertheless also considered that a "crown jewel" remedy[103] was appropriate in the form of a sale of the entirety of the target's business by a divestiture trustee if Stericycle could not successfully implement the partial divestiture within a certain period.[104]
- The CC determined in *Stonegate Farmers/Deans Food*[105] that the most effective remedy was to unwind the transaction through the divestiture of the smaller of the two companies Stonegate Farmers. In trying to resist an unwinding of the transaction, the merger parties argued that it would not be possible to undo complicated financial arrangements that had been put in place at the time of the merger. The CC nevertheless considered that this did not constitute a reason for not seeking to remedy a substantial lessening of competition since this would allow parties to frustrate the remedy options available in the case of completed mergers.[106]

100 CC decision of January 23, 2007.
101 CC decision of December 12, 2006.

102 The CC would not permit the "put or pay" contract to last beyond six months given a concern that this would otherwise undermine the purchaser's incentive to compete effectively with Stericycle.
103 The CC also accepted a crown jewel remedy in *Railway Investments/Marcroft*, CC decision of September 12, 2006, with the commitments comprising a partial divestiture in the first instance, followed by sale of the entire target business if the partial divestiture failed and the purchaser sought the entire business.
104 Interestingly, in this case the CC also made a recommendation to the NHS to the effect that its contracts for the disposal of healthcare risk waste should not exceed seven years and the period between announcing the award and commencement should not be less than 12 months so as to lower entry barriers particularly in the case of bidders who need time to build up the required staff and equipment to service the contract if successful.
105 CC decision of April 20, 2007.
106 More generally, the CC takes the view that it should not take into account the costs of divestiture to the parties in completed transactions since it is open to merging parties to condition their transactions on competition authority approval and since the CC would expect the risk of closing prior to obtaining approval to be reflected in the purchase price. See para.4.10, *Merger References: Competition Commission Guidelines, CC2,* June 2003.

Notwithstanding these trends, a certain degree of flexibility to accept innovative solutions in appropriate circumstances is also apparent. In *Tetra Laval/Carlisle Process Systems*, the OFT for the first time accepted an IP licence as the sole remedy. The parties agreed in *Flybe Group/BA Connect* to vacate a parking stand at Southampton to allow a new entrant on the problem routes between Southampton and Edinburgh and Southampton and Manchester.[107] Equally, in *Vue Entertainment Holdings (UK)/A3 Cinema*,[108] while the CC insisted on a cinema divestiture to address the Competition Commission's concerns regarding the overlap in Basingstoke, Vue was allowed, subject to certain conditions, to conduct a sale and leaseback of the relevant cinema site prior to divestiture to enable Vue to realise the full value of the long-term lease with rent.[109]

Concluding remarks

Developments over the past 20 months are likely to have led to a number of lasting changes within the UK merger control regime. First, while the OFT has shown itself capable of clearing transactions involving high combined shares and determined complainants, there are now additional pressures particularly on the OFT but perhaps also on merging parties during the first phase investigation process. The OFT must produce even more detailed and sufficiently reasoned decisions, while there is a continuing emphasis on merging parties and their advisers to ensure that their arguments are sufficiently substantiated. Similarly, third parties complaining about a transaction will not likely be successful in their aims without credible and compelling evidence.[110] Secondly, completed mergers will more often be subject to hold-separate undertakings, which may result in fewer numbers of purchasers being willing to complete their acquisitions prior to OFT approval. Thirdly, the OFT and the CC will be more strict when negotiating remedies with merging parties and may be less likely to accept behavioural commitments, especially those involving price controls. There will also be an onus on the merging parties to show why remedies short of restoring the status quo should be accepted. Finally, as the CAT appeal process continues to be flexible and swift, there will likely be an increase in the number of OFT and CC decisions appealed to the CAT.

107 OFT decision of February 7, 2007.

108 CC decision of February 24, 2006.

109 See also *Boots Group/UniChem*, OFT decision of February 6, 2006, where the OFT permitted the merging parties to provide finance to the purchasers so long as the finance was provided on an arm's length basis and reasonable commercial terms, would not compromise the purchaser's independence or ability to compete with Boots, and was repayable at three months' notice.

110 The OFT may nevertheless feel compelled to refer a particular transaction given the sheer volume of complainants in a particular case.