

UK MERGER CONTROL: RECENT DEVELOPMENTS

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The most prominent recent developments in UK merger control are the protracted News Corp/BSkyB saga and the Ryanair v. OFT litigation at the CAT. The former has been analysed exhaustively and the latter will be illuminated by the forthcoming judgment of the CAT. This update therefore leaves these cases to one side and instead discusses three other topical merger control issues: the counterfactual; the “timeliness” test for new entry; and the use of hypothetical questions in merger surveys.

I. THE COUNTERFACTUAL:

GETTING THE BALANCE RIGHT BETWEEN PHASES 1 AND 2

The “Merger Assessment Guidelines” state¹ that “*The OFT considers the effect of the merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect*” and that the counterfactual will be altered to take account of a failing firm only if that firm would “*inevitably*” have exited from the market. This approach – which implies that the OFT will commonly refer a merger involving a failing firm argument, only for the CC to clear it – can be questioned on both practical and theoretical grounds.

The practical issues are illustrated by Ratcliff Palfinger / Ross & Bonnyman, in which RP agreed to buy R&B’s business of supplying spare parts for commercial vehicle tail lifts. The transaction did not include R&B’s business of manufacturing and supplying the tail lifts themselves. The OFT found that the counterfactual was one in which R&B would have continued to supply tail lifts themselves; the merger may have caused R&B to exit from the market for tail lifts themselves; and this gave rise to a realistic prospect of an SLC in the market for tail lifts. The OFT emphasised² that it was “*mindful of its cautious approach*” and

¹. Para. 4.3.5.

². At para. 48.

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was “not persuaded that R&B’s commercial tail lifts business would inevitably have exited imminently and that its strategic decision to exit this line of business was not influenced by the Transaction”.

The CC took less than four months to prepare a short report in which it found that R&B did not wind down its tail lift manufacturing business in order to facilitate the sale of its spare parts business or as a consequence of that sale. It therefore found that there were no competition concerns in the manufacture and supply of tail lifts and cleared the transaction.

The practical concern arising from *Ratcliff Palfinger* is that the OFT seems to have had access to the same documents as the CC and to have had the same ability to question relevant executives.³ Since the OFT routinely carries out analysis that is as detailed as the analysis carried out by the CC in this case, it is not clear why the parties, the public and the merged group’s customers should be put to the cost and delay of a second phase investigation when the OFT could have reached the same conclusion as the CC on exactly the same evidence.

The *Ratcliff Palfinger* case is not unique: there are some similarities with *Stena / DFDS* (although the Competition Commission’s report is not in short form, in part because the CC’s findings on the counterfactual did not determine the outcome of the investigation) and there is a good prospect that *Dorf Ketal / Johnson Matthey* would have been approved by the CC, although the parties abandoned the transaction following the reference. The CC will also have to grapple with this issue in *Kerry Foods / Headland Foods* which was referred recently.

There are three theoretical concerns about the OFT’s “cautious” approach. The first is that, as noted above, the OFT selects “the most competitive counterfactual” provided that it considers that scenario “to be a realistic prospect”. However, the “realistic prospect” test is applied to the ultimate issue, namely whether the merger has resulted, or may be expected to result, in an SLC. If the “realistic prospect” test is applied to each element in the analysis, the effect is to change the test applicable to the ultimate issue. Assume, purely for the purposes of illustration and recognising the artificiality, that “realistic prospect” can be expressed as “a 10 per cent. chance”. If there is a 10 per cent. chance that the counterfactual is scenario X and there is a 10 per cent. chance that in scenario X there will be an SLC, but

³ Of course, if the parties refuse to provide documents to the OFT or to make decision makers available at the issues meeting or otherwise, the OFT could make a reference to take advantage of the CC’s more powerful tools for gathering evidence.

on all other scenarios there will not be an SLC, then there is a 1 per cent. chance of an SLC; but there is a “realistic prospect” that the counterfactual is scenario X and there is a realistic prospect within scenario X of an SLC. On this *highly stylised and entirely artificial example*, the transaction would be referred even though a 1 per cent. chance of an SLC falls well below our assumed 10 per cent. threshold for finding that there is a realistic prospect of an SLC.

The second theoretical concern is that applying a test of “inevitable” exit is unduly demanding. The test for the OFT is whether there is a realistic prospect of an SLC. Disregarding exit that was almost, but not entirely, certain to occur risks leading the OFT into error as there will be cases in which it finds a realistic prospect of an SLC when there is none.

The third issue relates to the coherence of the merger control system. The OFT will approve a merger that is expected to increase prices to the detriment of consumers, so long as new entry is judged to be timely, likely and sufficient. A merger may be approved on the basis that entry is likely – but not inevitable – and that entry may not in fact occur, with the consequence that the merger harms consumers. By contrast, demonstrating that the exit of one of the merging parties was very likely – but not inevitable – is not sufficient to obtain approval from the OFT. The risk of harm to consumers may be the same in both cases, but one will be cleared and the other referred. Whilst there is a difference in that the merging parties generally control most of the evidence relevant to exit, this should go to the OFT’s assessment of the reliability of the evidence and not the standard of proof.

2. NEW ENTRY: HOW SOON IS “TIMELY”?

The “Merger Assessment Guidance” states that when applying the test of whether new entry will be timely, *“The Authorities may consider entry or expansion within less than two years as timely, but this is assessed on a case-by-case basis, depending on the characteristics and dynamics of the market, as well as on the specific capabilities of potential entrants.”*⁴ In *Zipcar / Streetcar*, the CC found that entry would be timely since *“a new entrant could broadly replicate the pre-merger constraint of Zipcar within a few years.”*⁵ The CC found that *“price rises were likely in the short term”* but entry and expansion would prevent the merged group from *“exercising market power to the detriment of consumers in the medium to long term.”*⁶

⁴ Para. 5.8.111.

⁵ Para. 7.56.

⁶ Para. 7.57.

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The reference to “a few years” is not precise, but seems to connote a period of more than two years – probably three years. Whilst it is easy to identify cases in which periods of longer than two years might be appropriate (e.g. if there is a small number of customers and none of the contracts expire within the next two years⁷ or the market is for durable goods and many customers could defer their purchases), it is not clear why Zipcar received relatively generous treatment, given the finding that the merger would lead to price rises in the short term.

3. SURVEYS: ARE WE ASKING THE RIGHT QUESTIONS?

In *Stena / DFDS*, the CC commissioned a survey of the parties’ customers asking how they would respond to hypothetical route closures and price increases. The survey evidence suggested that there would be more significant switching between corridors (categories of ferry routes between Great Britain and the island of Ireland) than “*the preponderance of non-survey evidence*”.⁸ In particular, some of the survey results were counter-intuitive and others were inconsistent with actual behaviour by customers.⁹ The CC approved the transaction unconditionally, but there is an obvious concern that if less non-survey evidence were available, the survey results would have taken on greater significance and might have led the CC to different – and incorrect – findings.

This case serves to illustrate the concerns expressed in response to the consultation by the OFT and CC on “Good practice in the design and presentation of consumer survey evidence in merger inquiries”¹⁰, namely that the authorities were “*too sanguine about the ability of survey design measures to reduce hypothetical bias*” (although it should be emphasised that the CC was *not* too sanguine in the *Stena* case as it discounted the survey evidence in approving the transaction). This point is especially important in the light of the growing use by the OFT of IPR modelling – which is often based on survey evidence – in complex retail chain mergers, such as *Asda/Netto*.

⁷ See *Ordnance Survey/Local Government Improvement and Development*, paras 84 and 85 for discussion of a long-term contract preventing an SLC from arising.

⁸ Summary, para. 14

⁹ Paras 9.38 and 9.40.

¹⁰ OFT1230resp; CC2com 1 resp, paras 2.62 to 2.64.

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