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A New Style of Merger Review in the U.K.: Perspectives on the Proposed Reforms

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I. INTRODUCTION

The Enterprise Act 2002 (the “Act”), when it came into force in July 2003, required the U.K. Office of Fair Trading (the “OFT”) and the U.K. Competition Commission (the “CC”) to publish guidelines on how it was to be applied to mergers. The result was the publication of a suite of guidelines by both the OFT and the CC. Their purpose was to inform the business community how the Act would apply to and affect merger transactions. From a lawyers’ perspective, the guidelines were a statement of how the authorities interpreted the Act and how they would enforce it.

Of these guidelines, the CC’s *Merger References: Competition Commission Guidelines* (the “Substantive Guidelines”), and the OFT’s guidance on procedural and jurisdictional issues (the “Procedural Guidelines”) cover some of the most common and important issues that arise in mergers assessment. A number of these issues are core features of the U.K. regime, such as:

- i.** how a “substantial lessening of competition” (or “SLC”) is identified;

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- ii. how the test for “reference” to the CC is applied (under which the OFT is obliged to refer a merger to the CC for an in-depth Phase 2 review); and
- iii. the procedures for notification, case review, and agreeing remedies.

It is no surprise, therefore, that the Substantive Guidelines and the Procedural Guidelines quickly became the starting point for those trying to understand how the authorities would apply the Act to their merger.

Yet these guidelines were published at a time when the Act was new and untested. Many of the legal provisions on which guidance was offered, such as the rules on “public interest” mergers¹ and power to accept “initial undertakings”² had not been applied in practice. Questions also existed as to how the Courts would interpret key provisions of the Act, such as the test for “reference.”

Five years have now elapsed since the introduction of the Act and the publication of the Substantive and Procedural Guidelines. Over this period, the Act and the Guidelines have been regularly applied in practice, and several key aspects of the Act have been scrutinized by the courts. The net effect has been that the process of merger review today has progressed considerably from that described in the existing Substantive and Procedural Guidelines.

¹ The Act provides special rules allowing governmental intervention during the review of mergers that give rise to “public interest” considerations. These considerations are currently defined as national security interests or the need to ensure sufficient plurality in the U.K. media.

² “Initial undertakings” are sometimes also referred to as “hold separate” undertakings because they require the purchaser to run the target business or assets on an arms length basis as a self-standing and going concern for the duration of the merger review period. They also include obligations requiring the purchaser to operate the target in line with its ordinary course of business and prevent the extraction of any commercially sensitive information from the target.

In view of these developments, both Guidelines are currently being reviewed by the OFT and the CC in order to reflect developments in their practice and procedure. They will also incorporate legal developments, identified by the courts or through decisional practice, which will inevitably influence the way in which the Act is applied to mergers going forward.

The final product of the OFT's and the CC's reviews will reflect their understanding of the Act and how they should apply it. Consequently, the preceding consultation period provides a useful opportunity to understand what the authorities are thinking, especially what developments they consider to be important and how they should react. It also provides a useful opportunity for the business and legal community to contribute to this debate.

After providing a brief background to the reviews, this article reflects on some of the key developments over the last five years, and offers a lawyer's critique of what might matter most to the authorities as they draw up their revised Guidelines.

II. THE BACKGROUND

The current reviews of the two Guidelines were started on the OFT's and CC's own initiative. The Act leaves the conduct of these reviews to the OFT's and CC's discretion, and it also gives them considerable latitude over what advice and information their final Guidelines should provide. Taking advantage of these provisions, both authorities have embarked on their reviews in a pragmatic, but consumer-friendly, way. For example, they have held information seminars for stakeholders and encouraged

debate and feedback. This approach is likely to promote greater understanding and awareness of U.K. merger procedures, which can only be welcomed.

At the same time, legal advisors will also be encouraged by the greater degree of co-operation between the OFT and the CC during the course of these reviews. Notably, although the review of the Substantive Guidelines was started by the CC, it is now being conducted jointly with the OFT in recognition of the fact that these Guidelines cover issues relevant to both authorities. Ensuring consistency in approach is illustrative of the authorities' recognition that they are in fact applying the same rules and should, therefore, share the same analytical approach to substantive issues. A formal consultation draft of the Substantive Guidelines is intended to be published towards the end of this year.

The OFT's review of its Procedural Guidance follows a different track given that it largely covers issues relevant only to the OFT during a Phase 1 review. Nevertheless, it is clear that the two authorities are also cooperating closely in the production of these guidelines. Initial indications suggest that the OFT's draft guidance on jurisdictional issues may become a joint work with the CC. A revised draft of the Procedural Guidelines is already available for comment.

Simultaneously, the CC is also consulting on revised merger remedy guidelines (the "Merger Remedy Guidelines"), for which a revised draft is also available for comment. We are unlikely to see the CC seek to produce this jointly with the OFT in view of the different powers given to each authority under the Act. However, there can be

little doubt that the OFT will have considerable input behind the scenes.

III. A CRITIQUE OF WHAT THE GUIDANCE MAY CONTAIN

Those already familiar with the existing Guidelines will be aware that they cover a wide array of issues within the mergers review process. Certain key trends rooted in the authorities' decisional practice can nevertheless be identified and are already reflected in the draft Procedural Guidelines or are likely to feature in the revised Substantive Guidelines. We discuss below several of those trends that may become a key part of the authorities' revised Guidelines.

A. Use of "Initial" Undertakings

The on-going cooperation between the OFT and the CC alluded to above is also reflected in their harmonized approach to the increasingly frequent use of "initial" undertakings for completed mergers. Indeed, both the OFT's consultation on the Procedural Guidelines and the CC's consultation on the Mergers Remedy Guidelines elaborate on how the authorities intend to use such undertakings.

The Act has always allowed the OFT and the CC to make use of "initial" undertakings to prevent parties integrating their businesses in a manner that could frustrate a divestiture remedy being imposed. Whereas the CC's practice of seeking such undertakings has now been established for several years, the OFT's use of such undertakings has recently become much more commonplace. The trigger for this development appears to have been the Competition Appeal Tribunal's (the "CAT") ruling in the *Stericycle* litigation in which it supported the CC's use of "initial" undertakings in

a completed merger situation. Since then, the CC has published its template “initial” undertakings and has applied them in several cases. The OFT has also adopted a similar approach and recently published its own template “initial” undertakings, which bear a close resemblance to the CC’s template.

The authorities may publicly argue that the use of such measures are necessary to preserve their ability to restore competition if there is a finding of an SLC. However, there is growing unease that the increasing frequency of this practice, especially by the OFT, is tipping the balance against the basic principles of the U.K.’s voluntary merger regime, whereby parties are entitled to complete merger if they are willing to take the risk that the authorities’ merger decision may go against them. The voluntary nature of the U.K. regime was widely supported during the consultation period prior to the adoption of the Act. One would therefore expect there to be resistance to measures that could potentially undermine this aspect.

B. An Increased Emphasis on Evidence

An evidence-based approach has always been a key feature of the authorities’ approach to merger assessment under the Act. Its importance was further underlined by the CAT in the *Unichem* litigation where the OFT’s decision to clear a merger was overturned because it had failed to confirm through market testing that evidence of future market entry, on which it relied, was correct. Since this judgment, there has been a marked trend towards a forensic examination of the evidence supplied by the parties. Lawyers have also noted the increasing length of OFT clearance decisions, which now

devote much more attention to explaining the evidence on which the OFT places weight.

It would therefore be unsurprising if one were to see the revised Substantive Guidelines stress in detail that merging parties will be required to support their arguments and opinions with evidence. Few would argue with this approach. However, the business community will be keen to ensure that the authorities continue to recognize that there may be occasions where it is not possible to evidence the parties' opinion of how the market will evolve. Opinions given in good faith must also continue to have a place in the merger assessment process, and should be given appropriate weight when evaluating transactions.

C. Looking at Substance Not Form

An increased focus on the underlying evidence has brought with it a greater willingness on the part of the OFT and the CC to look at the underlying “dynamic” of a merger situation. The OFT recently described this approach in the *Wood Green Cinema* case as looking at the “substance of a transaction over its form.” The CC’s in-depth examination of material influence in *BSkyB/ITV* illustrates a similar approach, where it called on the parties to provide detailed evidence not just in relation to special resolutions and annual general meeting attendance, but also on information flows between ITV and its shareholders, the conduct of board meetings and the impact of a commonality of shareholders in both companies.

Both the business community and advisors should welcome this approach, but not at the expense of legal certainty. “Bright line” rules may be a luxury, but some degree of

certainty is essential for business. Although a “substance over form” approach may allow the authorities flexibility in dealing with difficult situations, they should be wary of allowing this to undermine efforts to develop clear thresholds on areas such as “material influence.”

D. Greater Control Over the Implementation of Remedies

The CC’s draft Merger Remedy Guidelines indicates a more assertive approach to identifying and implementing remedies. It is clear that the CC intends to seek to deliver remedies itself instead of relying on third parties, such as the government, to address structural defects in the market. This proposal may reflect frustration on the CC’s part with the current process under which it has found parties unable to execute remedies in certain cases. The draft Merger Remedy Guidelines also show a desire on the CC’s part to exert greater control over the divestment process, for example, by appointing a monitoring or divestiture trustee prior to the expiry of the divestment period where necessary.

The OFT has indicated a similar approach in its draft Procedural Guidelines in relation to agreeing “undertakings in lieu.”³ Its recent decision in *Homebase/Focus*, where the parties were required to find an “upfront buyer” due to the limited number of suitable purchasers, has been cited as an example of how the OFT will proceed in such cases in the future.

One obvious consequence of this trend must be to make it harder for merging parties to execute remedies or undertakings in lieu within acceptable deal timetables or in

³ The “undertakings in lieu” process allows the merging parties to avoid a reference to the CC by offering remedies that meet the OFT’s competition concerns during its Phase 1 review.

a commercially viable manner. If the authorities believe their “tougher” approach is necessary, which clearly they do, then it is also necessary for them to provide clear and explicit guidance on how the parties should proceed in difficult cases.

E. Updating the Guidance for Recent EC Developments

It is no secret that the competition authorities in the Member States cooperate extensively with one another in competition law enforcement. The same applies for merger review where it is in everyone’s interests that there should be a unity of views on the analytical approach to merger assessment. The CC’s and the OFT’s decisional practice may be in step with the latest decisional practice in Brussels but, unfortunately, the Substantive Guidelines are not.

The current reviews, therefore, provide an excellent opportunity for the authorities to consider and reflect (where appropriate) the lessons from the European Commission’s in-depth analysis of a number of complicated types of economic effects in recent cases (e.g., vertical and conglomerate effects, and coordinated effects, especially). The lessons learned by the Commission in these cases could be usefully reflected in the revised draft of the Substantive Guidelines.

F. Timing of Merger Review

OFT’s draft Procedural Guidelines also raise a number of practical issues specific to the Phase 1 review process. One key aspect is the OFT’s suggestion that the statutory “Merger Notice” procedure, which provides a fixed 20- to 30-working-day review period, should only be used for transactions that raise no competition issues. Where there are

likely to be competition issues, the OFT would prefer the merging parties to use the longer “Informal Submission” procedure under which the OFT would normally take 40 working days to issue its decision.

Although some may have sympathy for the OFT’s position, it is likely to be of concern to the business community that Phase 1 merger review in the United Kingdom will, if the OFT’s suggestion becomes practice, take longer than almost anywhere else in the European Community. Moreover, it moves the U.K. regime further away from international norms even though the OFT is an active member of the International Competition Network, which promotes a Phase 1 review period of no more than one month.

IV. CONCLUSIONS

Without a doubt, the changes resulting from the OFT’s and the CC’s review of their Guidelines are likely to be important. Once the revised Guidelines are finalized, they will set tone for mergers assessment over the next few years. The business community will be on notice that the authorities intend to pursue a much more rigorous and forensic approach to the assessment of their transactions, and will not hesitate to utilize their powers to put a stop to mergers where they have concerns.

In addition, the complicated way in which the regime operates and significant powers at the authorities’ disposal will make the pitfalls of “getting it wrong” much more serious than ever before. There is a responsibility on the authorities to employ their powers in a proportionate and reasonable manner. However, given the benefit of statutory

discretion working in the authorities' favor, it is likely that the majority of the burden will fall on the business community to understand and respond to the changes to the OFT's and the CC's practice.