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Crawling Out of Recession, Towards Fresh M&A Activity

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Still in the wake of the financial crisis, the nadir of UK merger activity continued in 2010. Only one reference to the Competition Commission (CC) has been made so far this year (the deal was recently abandoned).[1] Given the dearth of deals, the UK competition authorities' merger officials are focusing their attention on substantive legal reform, choosing to combine their respective substantive guidelines into a single guidance document. After full consultation, the OFT/CC Substantive Merger Asssesment Guidelines are due to be published imminently, in time for the beginning of the next M&A cycle. With interesting potential cases already in sight, such as News Corp's proposed acquisition of the outstanding shares in BSkyB, 2011 promises to be a good opportunity for the authorities to put their harmonised approaches into practice.

Jurisdiction and procedure

The Enterprise Act 2002 (the EA02) provides the OFT with powers to investigate relevant merger situations and assess whether they have resulted in, or may be expected to result in, a substantial lessening of competition in any market or markets in the UK (the SLC test). Despite ongoing debate on the relative merits of the voluntary regime, UK merger control rules still contain no requirement to seek or obtain merger clearance before completing a transaction. Nevertheless, the UK competition authorities have the power to investigate transactions and may prohibit transactions or impose remedies similar to all mandatory filing regimes around the world. This introduces an additional dimension into UK merger control advice for clients, ie, whether to notify reviewable transactions for clearance prior to completion or take the risk that the competition authorities may later investigate and, possibly, unwind the deal or impose substantial remedies.

Relevant merger situations

There has been no change to the UK jurisdictional thresholds. A relevant merger situation will still arise when the following conditions are met:

- two enterprises (broadly speaking, business activities of any kind) cease to be distinct;
- either the merger has not yet taken place or the merger has taken place not more than four months before the reference is made, unless the merger took place without having been made public and without the OFT being informed of it;[2] and
- either:
  - the turnover of the acquired enterprise in the UK exceeds £70 million (the turnover test); or
  - the transaction creates or enhances a share of supply of goods or services of a particular description in the UK of 25 per cent or more (the share of supply test).

In determining whether two or more enterprises will cease to be distinct, the OFT looks not only at acquisitions of legal control, but also at acquisitions of de facto control over company policy and acquisitions of a lesser 'material influence' over company policy. The OFT will generally be prepared to consider an acquisition of a shareholding of 15 per cent or more to ascertain whether it may confer material influence. So, for example, the Court of Appeal upheld the approach taken by the CC in relation to BSkyB's acquisition of a 17.9 per cent stake in ITV,[3] which approach drew upon, inter alia, evidence of BSkyB's attendance and voting at recent ITV shareholders' meetings.

In spite of the difficulties the share of supply test presents for merging parties – on account of the great discretion it affords to the OFT to define the reference products and services – it is still one of the two alternative jurisdictional size thresholds. The share of supply test is satisfied when the merger itself creates or enhances a 25 per cent share of supply or purchases of any goods or services in the UK (or in a substantial part of it).[4] The share of supply test also gives the OFT a wide discretion regarding the geographic frame of reference. The OFT has found a substantial part of the UK to be as narrow as parts of cities, such as the London Borough of Haringey.[5]

The EA will not generally apply to any transaction falling under the European Commission Merger Regulation (ECMR)[6] in the absence of a referral back to the OFT (see below).

To notify or not to notify?

Even where it can readily be established that a transaction is likely to qualify for investigation, there is no obligation to notify it to the OFT and no blacklisting of firms for not notifying. Thus, benign transactions with no material overlaps or no complex vertically affected markets are often not notified. The risk of not notifying becomes material only in cases which may give rise to significant competition issues. Such transactions which are completed and implementation commenced without notification can create problems if the CC ultimately decides that they should be unwound or subject to significant remedies; but this is a risk that the merging parties (primarily the purchaser) are entitled to take.

Having said this, in recent years a perceived increase in the number of completed, partially anti-competitive mergers which are reviewed by the OFT/CC[7] has resulted in much stronger use of hold-separate undertakings, designed to prevent the integration of the businesses pending conclusion of the authorities' review.[8] This has also sparked renewed calls for a compulsory notification regime in the UK.

Merger filings

Once they have decided to make a notification, merging parties can use either the statutory voluntary pre-notification procedure, or otherwise make an informal submission in accordance with the OFT's administrative procedure. Merging parties can typically expect a decision within 20 and 40 working days, depending on the notification procedure adopted. Where the OFT believes that an SLC may be expected to arise or may have arisen, it has a duty under the EA02, with limited exceptions, to refer the transaction to the CC for an in-depth investigation.

The statutory procedure, used in straightforward public offers, requires the OFT to issue a decision within 20 working days, sub-

ject to a possible extension of 10 working days. Many practitioners still prefer to use the OFT's administrative procedure, particularly in more complex cases, as it allows the OFT more time to conduct its assessment, thereby reducing the chances of a referral to the CC. Under the OFT's administrative procedure, the parties can generally expect a decision within 40 working days. Merging parties must also pay a fee for their merger to be reviewed. Since 1 October 2009 the fees payable are: £30,000 where target's UK turnover is less than £20 million; £60,000 for a UK turnover of between £20 million and £70 million; and £90,000 for a UK turnover of over £70 million.

OFT reviews and duty to refer

Under EA02 the OFT has a duty to refer a qualifying merger to the CC where the OFT believes that it has resulted in or may be expected to result in a substantial lessening of competition (an SLC) in a market or markets in the UK. The OFT must make a reference to the CC when it believes that the merger is more likely than not to result in an SLC. The EA02 also contemplates reference at lower ranges of probability. Specifically, if the OFT believes that the relevant likelihood is greater than fanciful, but below 50 per cent, it has a wide margin of discretion. In such cases, the OFT has the duty to refer when it believes there is a realistic prospect that the merger will result in an SLC.

Having said this, the duty does not apply where:

- the competition concerns can be resolved by agreeing binding undertakings with the merging parties (undertakings in lieu);
- the merger is insufficiently advanced to warrant a reference;
- the affected markets are not of significant importance to warrant a reference (de minimis); or
- the customer benefits resulting from the merger outweigh its adverse effects.

Undertakings in lieu need to be clear-cut solutions to the competition concerns. The UK authorities generally prefer structural to behavioural remedies, although the UK is perceived to be more amenable to behavioural undertakings than the European Commission, particularly as regards pricing remedies. In 2010 the OFT accepted undertakings in lieu of a reference in three cases,[9] all of which were structural undertakings, with the OFT requiring the parties to find an upfront buyer in two of the cases.

The OFT is due to publish revised guidance on exceptions to the duty to refer in the coming months.[10] In the meantime, as regards existing OFT application of the de minimis exception,[11] the OFT may apply this exception to markets worth less than £10 million in aggregate unless there is high market concentration and low entry prospects or there is evidence of coordination. The OFT's key concern is whether the impact of the merger is likely to be particularly significant.[12] Further, the OFT has also confirmed that as a matter of general policy it will not exercise its discretion under the de minimis exception when the harm to competition can, in principle, be clearly remedied by undertakings in lieu. The OFT recently applied the de minimis exception to local bus routes in acquisitions by Arriva and Go-Ahead in the north-east of England.[13]

The OFT may also exercise its discretion not to refer a merger where any relevant customer benefits in relation to the creation of the merger situation outweigh the SLC and any adverse effects of it. Such customer benefits could include lower prices, greater innovation or greater choice or quality. Again, the OFT has indicated that it is likely to be rare that there will be sufficient evidence at this stage of the investigation of customer benefits resulting from the merger to convince it that a merger, which it believes results in an SLC, should not be referred. The OFT has yet to invoke the customer benefits exception.

Competition Commission's key inquiries

The CC has a period of 24 weeks, subject to a possible eight-week extension, to report on whether the referred transaction constitutes a relevant merger situation and, if it does, whether that merger situation has resulted in, or may be expected to result in, an SLC within any market or markets in the UK. Pending the conclusion of its inquiry, the CC has a broad range of powers to prevent the parties from integrating the businesses (interim orders). Where the CC concludes that there is an SLC, it may either accept undertakings from the parties or otherwise impose remedies, including prohibiting the merger.

Proposed transactions that are made conditional on clearance from the OFT may lapse following a reference to the CC where the purchase agreement is conditional on the OFT not deciding to refer the transaction to the CC.[14] Even where the transaction is not conditional on clearance, the parties may agree to back out of it where faced with the prospect of a lengthy and expensive inquiry by the CC, as occurred recently in *Getty Images*.[15]

Given the parcity of M&A activity over the past year in particular, there has only been one merger reference to the CC so far this year, which deal was abandoned. In any event, the majority of referred mergers continue to be cleared by the CC. So far in 2010, the CC has completed four merger inquiries. In three of those cases, the CC found no SLC. Where the CC found an SLC it required a divestment remedy. No mergers have been blocked so far in 2010.[16]

Following an in-depth review of the completed acquisition by Sports Direct of 31 JJB Sports stores, the CC did not find an SLC.[17] Although the CC's customer survey found that customers considered the merging parties to be their closest competitors, indicating a narrower market, for historic reasons the merging parties were prevalent in different parts of the UK. Further, the CC found no compelling evidence that the acquisition would increase the likelihood of tacit coordination. Sports Direct and JJB were strong in different areas of the UK and the store transfers changed the number of areas of relative strength somewhat, particularly in London. Moreover, recent store openings by both parties did not indicate any coordination. In finding no SLC, the CC undertook a number of economic studies, a continuing trend in CC investigations.[18]

The CC cleared the proposed *Brightsolid/Friends Reunited* merger on the grounds that there was considerable differentiation between the parties' family history offerings, and that Ancestry would continue to be the largest provider of online genealogy services after the merger and would continue, along with other players, to be a significant constraint in the market.[19] Further, the merger was unlikely to give rise to coordinated effects because the market lacked sufficient transparency and the merged firm would also be much smaller than Ancestry, so the firms would be less likely to coordinate.

Finally, in addition to reporting on *Ticketmaster/Live Nation*,[20] the CC has continued the implementation of the divestment remedy it ordered Stagecoach to make after its acquisition of Preston Bus.[21] Stagecoach's partially successful appeal to the Competition Arbitration Tribunal (CAT) on the grounds of proportionality of the remedy has resulted in the proposed marketing of a slightly reduced remedies package.

Political intervention

Although under the EA02 regime it is the competition authorities (the OFT and the CC) who are responsible for making the final decisions

as to any competition concerns, the regime provides that the secretary of state for business, innovation and skills (SoS) can intervene in cases which raise specified public interest considerations. There are currently three public interest grounds pursuant to which the SoS may intervene:[22] national security, media mergers[23] and, more recently, stability of the UK financial system, following the UK government's decision to intervene to save HBOS via an acquisition by Lloyds.[24]

There have been no intervention notices issued so far in 2010. At the time of writing, there is speculation that the SoS is considering intervening on media plurality grounds in News Corp's proposed acquisition of the outstanding shares in BSkyB.

Referrals to and from the European Commission

Under the ECMR, the OFT has the power to request that mergers notified to the European Commission be referred back for investigation by the OFT under the EA02 (article 9 references) and to refer UK mergers to the European Commission (article 22 references). The ECMR also enables merging parties to request that cases which would otherwise be notified to the Commission should instead be notified to the OFT[25] or to apply for the referral of mergers qualifying for investigation in three or more EU member states to the European Commission.[26]

The OFT has made few requests for jurisdiction during the financial crisis. On 2 February 2010 the OFT requested a reference of the *Orange/T-Mobile* JV, which request was subsequently withdrawn once the parties offered satisfactory remedies to the European Commission.[27] Conversely, on 17 March 2010, the OFT requested that the European Commission investigate the UK aspects of Procter & Gamble's proposed acquisition of Sara Lee's air-care business due to the cross-border effects of the deal. The European Commission accepted jurisdiction from four other member states, in addition to the UK.[28]

OFT/CC Joint Review of Substantive Merger Assessments

The imminent publication of the Joint OFT/CC Merger Assessment Guidelines is to be welcomed because it consolidates the authorities' approaches and experiences since the EA02 entered into force. This should improve transparency and efficiency for merging parties, as well as harmonisation in approach between the authorities. The UK being unusual in having two competition authorities, the new Guidelines aim to ensure that the right cases are dealt with by the correct authority in the right way. The Guidelines will take a more economics-based approach to merger assessments. In particular, there will be a shift away from rigid market definitions towards competitive effects, and further guidance on selection of the appropriate counterfactual, the application of the unilateral and horizontal effects theories of harm, and clarification of the application of the efficiencies and failing firm defences (the latter of which the UK authorities have relied on increasingly during the financial crisis).

Appeals

There have been several high-profile and important appeal cases in relation to the EA02 regime, in particular the Court of Appeal's (CA) judgment in *BSkyB/ITV*.[29]

On appeal in September 2008, the CAT had dismissed an application for review of the CC/SoS decision relating to BSkyB's acquisition of approximately 17.9 per cent of ITV. The CAT agreed that the acquisition had led to a relevant merger situation as BSkyB had acquired the ability materially to influence the policy of ITV. The CAT also upheld the CC's findings that this merger would lead to an SLC in the all-TV market. However, the CC had erred in its assessment on media plurality, which conclusions the CAT set aside.

On 20 January 2010, the CA confirmed that the CAT had applied the appropriate standard of review and had rightly rejected BSkyB's challenge to the standard of proof and counterfactual analysis. It also dismissed BSkyB's appeal relating to remedies. On media plurality, however, the CA preferred the CC's approach to that of the CAT because it allowed the CC to take into account the actual extent of the control exercised. It therefore allowed the appeals brought by BSkyB, the CC and the SoS on media plurality and quashed the CAT's decision overturning this aspect of the CC's report. The CA noted that it was unsatisfactory that the media plurality provisions had been open to these conflicting interpretations and noted that it might be desirable to amend the legislation if the protection of media plurality afforded by the Court's interpretation was not considered adequate. Following the CA judgment, BSkyB gave undertakings to the SoS to reduce its shareholding in ITV to below 7.5 per cent.[30]

The other interesting appeal decision in 2010 was the CAT's judgment in *CTS Eventim v CC*.[31] Ticket retailer CTS had taken over from Ticketmaster as Live Nation's preferred supplier of ticket services, prior to Live Nation's merger with Ticketmaster. Despite finding an SLC provisionally, the CC reversed this and found an SLC in its final report.[32] CTS challenged the CC's decision on, inter alia, infringement of its right to a fair hearing, erroneous assessment of the counterfactual, and application of the SLC test. The CC requested that the CAT remit the matter back to the CC for reconsideration, on the basis that the ground relating to failure to consult was arguable in the circumstances, and that remittal was a more efficient and less costly means of dealing with the issue, and the CAT agreed. On 7 May 2010, after further consultation and analysis, the CC concluded that the merger would not give rise to an SLC.[33]

Notes

1 Anticipated acquisition by Getty Images, Inc of Rex Features Limited (ME/4522/10).

2 In this case the four-month period starts from the announcement or at the time the OFT is told.

3 *British Sky Broadcasting Group plc v* (1) *Competition Commission* and (2) *The Secretary of State* and *Virgin Media, Inc v* (1) *Competition Commission* and (2) *The Secretary of State for Business, Enterprise and Regulatory Reform* [2010] EWCA Civ 2.

4 Where one company already has a 25 per cent share of supply and the other has no share, this test is not satisfied; there must be an increment.

5 ME/3390/07 – *CineWorld Group plc/Hollywood Green Leisure Park*.

6 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

7 The OFT has a dedicated mergers intelligence office responsible for monitoring merger activity, drawing on multiple sources such as the press, complainants, government and other regulators.

8 It is now increasingly common for the OFT to request the merging parties to give 'hold separate' undertakings to the OFT (pursuant to section 71 of the EA02), in particular following the Competition Appeal Tribunal's judgment in the *Stericycle* case [2006] CAT 21.

9 Completed acquisition by Aggregate Industries UK Limited of Atlantic Aggregates Limited and of Stone Haul Limited (undertakings accepted on 3 March 2010 ME/3978/08); Completed acquisition by GB Oils Limited of Brogan Holdings Limited (undertakings accepted on 29 June 2010 ME/4406/10); Merger between the Co-operative Group Limited and Plymouth & South West Co-operative Limited (undertakings accepted on 26 March 2010 ME/4160/09).

10 According to the Joint OFT/CC Review of Merger Assessment Guidelines of April 2010, further information about exceptions to the duty to refer will be set out in forthcoming OFT publication Mergers-exceptions to the duty to refer and undertakings in lieu of reference.
11 OFT Guidance Exception to the duty to refer: markets of insufficient importance (OFT 516b) November 2007.
12 The OFT may still apply the exception if the impact of the merger on consumer welfare is limited. This is more likely to be the case where the merger has a limited impact where the period of any effects of the merger is more obviously finite and circumscribed. The OFT may also be unlikely to apply the exception if the case has significant precedent value, or a substantial proportion of the likely detriment is suffered by vulnerable consumers.
13 OFT press release 17/10: 'OFT decides not to refer *Arriva/Go-Ahead* North East Transactions to Competition Commission', 11 February 2010.
14 Or where the City Code on Takeovers provides.
15 Anticipated acquisition by Getty Images, Inc. of Rex Features Limited (ME/4522/10).
16 The CC blocked Project Kangaroo, however, in 2009: CC Report on the anticipated joint venture between BBC Worldwide Limited, Channel Four Television Corporation and ITV plc relating to the video on demand sector (4 February 2009).
17 CC Report on the acquisition by Sports Direct International plc of 31 stores from JJB Sports plc (16 March 2010).
18 Eg, the CC case team and economists conducted a critical loss analysis, which indicated that the store transfers had created an incentive for Sports Direct to increase its national prices by a very small amount (less than 1 per cent), as well as conducting an econometric analysis of entry.
19 CC Report on the anticipated acquisition by Brightsolid Group Limited of Friends Reunited Holdings Limited (18 March 2010).
20 CC Report on the completed merger between Ticketmaster Entertainment, Inc. and Live Nation, Inc (7 May 2010).
21 CC Report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited (11 November 2009).
22 Section 58 EA02.
23 The Communications Act 2003 introduced new media public interest considerations. These involve consideration of the need to ensure plurality of ownership of broadcasting companies and the need for high quality and diversified broadcasting in media mergers and considerations relating to the need for accurate presentation of news and free expression in newspaper mergers (sections 375-377, Communications Act 2003). The first media public interest intervention notice was issued in February 2007 in relation to BSkyB's acquisition of 17.9 per cent in ITV.
24 In September 2008, the Secretary of State intervened in the proposed acquisition of Lloyds TSB of HBOS on the basis that he believed that the stability of the UK financial system ought to be specified as a public interest consideration in section 58 EA02 and he believed that the stability of the UK financial system may be relevant to the consideration of the merger.
25 Article 4(4) ECMR.
26 Article 4(5) ECMR.
27 Case M.5650 *T-Mobile/Orange*.
28 Case M.5828 *Procter & Gamble/Sara Lee Air Care*.
29 *British Sky Broadcasting Group plc v* (1) *Competition Commission* (2) *The Secretary of State and Virgin Media, Inc v* (1) *Competition Commission* (2) *Secretary of State for Business, Enterprise and Regulatory Reform [2010] EWCA Civ 2*.
30 These undertakings were accepted by the SoS on 8 February 2010 and shortly thereafter the required disposal was completed.
31 *CTS Eventim v Competition Commission* [2010] CAT7.
32 CC Report on the completed merger between Ticketmaster Entertainment, Inc. and Live Nation, Inc. (7 May 2010).
33 The CC reissued its 22 December 2009 report as Further Provisional Findings and after considering the responses to that consultation published its Final Report on 7 May 2010, again concluding that the merger would not give rise to an SLC.

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Davina Garrod is a partner in Bingham's antitrust and trade regulation group and advises corporates, financial institutions and alternative investment funds on all aspects of M&A and EU/UK competition law (including state aid and restructurings). Davina has, in particular, assisted clients obtain merger control and other regulatory clearances around the world, as well as helping clients navigate the challenging EU antitrust and financial services regulatory landscape by providing strategic advice and analysis. Prior to joining Bingham, Davina was a partner at McDermott Will & Emery and coordinated their hedge fund practice group. She was seconded to a hedge fund in 2008 where she advised, inter alia, on M&A, antitrust and event-driven strategies and regulation. While working in Washington, DC, she provided EU, UK and US advice on a number of transactions, and has represented clients before the various EU institutions when based in Brussels and London. Davina has a BA (Hons)/MA (Hons) in law from Trinity Hall, University of Cambridge.


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