Competition Law: Regulation of Mergers and Acquisitions

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Part of the Collyer Bristow Competition Law Survival Pack

Where two or more companies merge their activities, clearance from the authorities may be required if the merger is large enough to impact on competition.

In the UK, merger control applies if either

- the UK turnover of the target is over £70 million; or
- the acquirer and the target:
  - (a) both buy (or sell) goods (or services) of a similar kind; and
  - (b) after merger they would buy (or sell) 25% or more of those goods (or services) in the UK or a substantial part of it.

The second test need not be a high bar. In one case, Slough (population: 140,000) was considered a "substantial part" of the UK.

Larger mergers may have a "European dimension" making them subject to EU control. The criteria are complex so not repeated here, but their applicability should be investigated if the parties have turnovers above £250 million or do business in three or more member states. In these cases, jurisdiction to review the merger rests with the European Commission. However, this article focuses on UK merger control.

Where the £70m turnover or 25% "share of supply" test is met, this triggers the OFT's jurisdiction to review the merger to decide if it could result in a substantial lessening of competition. If it could, the OFT hands the matter to the Competition Commission for detailed analysis.

It need not be a traditional merger

The £70m / 25% tests are applied where two (or more) enterprises cease to be distinct.

- The legislation defines "enterprise" to include part of a business's activities. The acquisition of part of another company's business may therefore be subject to regulation.
- The legislation defines "ceasing to be distinct" to include bringing the enterprises under common control which, at its lowest, can include one enterprise acquiring the ability materially to influence the policy of another. This could mean acquiring a 25% holding (enough to block special resolutions) or even less if, say, the other shareholdings are diffuse or the acquirer also obtains board representation. It could also mean a joint venture if, through veto, each party has the ability materially to influence the other. If your joint venture does not meet the £70m / 25% test, you may want consider if it could be an anticompetitive agreement.

Merger control procedure

There are two principle competition regulators in the UK - the OFT and the Competition Commission. The merger control procedure is divided into two phases: Phase 1 before the OFT and Phase 2 before the Competition Commission. The present government intends to merge these two functions within a single new body, the Competition and Markets Authority (the "CMA"), but the approach will be maintained, as Phases 1 and 2 will be handled by different divisions of that body.

Below is a brief summary of the procedure. A more comprehensive summary, co-written by the OFT and the Competition Commission, can be found here.

Phases 1: Where the OFT is notified (or becomes aware) of a merger, it must decide whether its jurisdiction is triggered under the £70m or 25% test and, if so, whether it thinks the merger may result in a substantial lessening of competition. If it thinks so, it must refer the case to the Competition Commission. However, this is subject to exceptions:

- The OFT need not refer mergers in markets of insufficient importance. As a rule of thumb, markets worth over £10m UK-wide are sufficiently important. With markets worth from £3m to £10m, the OFT will weigh the likely customer harm against the cost of a Competition Commission investigation.

Note: The Slough example above concerned Tesco's acquisition of a single Co-op store. This was sufficiently important because the test was whether the UK groceries market as a whole was worth over £10m.

- The OFT need not refer mergers where customer benefit from the merger - such as lower prices or greater innovation - is likely to outweigh the adverse effects of the substantial lessening of competition.
- The OFT may accept "undertakings in lieu" of a reference. Undertakings may be:
  - structural: such as a party selling off part of its business; or
  - behavioural: such as undertakings on price, although this is less satisfactory as it needs ongoing monitoring.

Unlike the EU, the UK does not insist that relevant merger situations are notified to the OFT, although not doing so carries the risk of the merger being reversed or having conditions imposed upon it which are less satisfactory than any undertakings that could have been negotiated beforehand.

As the OFT only has 30 (and the CMA will only have 40) working days from notification to make a Phase 1 decision, it is common to hold pre-notification meetings with the regulator to discuss its likely approach and possible undertakings.

Phases 2: In 2011-12, the OFT examined 103 mergers and found 79 of them met the £70m or 25% test, but there were only 9 references to the Competition Commission. Once companies identify the benefit of merger, they tend to prefer to negotiate undertakings than take their chances (and time) in Phase 2. We will therefore not go into detail about the process.

Suffice to say it can take half a year to reach a decision. It starts with fact-finding by the Commission, including meeting the parties, and maybe inquisitorial hearings to stress-test the views of the parties and any third parties who feel they could be affected by the decision. It will then decide whether to block the merger, allow it, or allow it subject to "remedies" like imposing price caps or obligations to refrain from conduct which may hinder competitors entering the market; compulsory licensing of IP to competitors; removing non-compete clauses in contracts, etc.

Substantial lessening of competition

Phases 1 and 2 are both concerned with analysing whether a merger will substantially lessen competition (or "SLC") in the affected "market". See our Introduction to Competition Law concerning market definition.

According to the OFT's and Competition Commission's joint guidance, they view competition as a process of rivalry between firms seeking to win business by offering a better deal, and they consider any merger in terms of its effect on this rivalry. A merger gives rise to an SLC when it has a significant effect on rivalry over time, and so on the competitive pressure on firms to improve their offer to customers or to become more efficient or innovative.
The OFT or, if it comes to it, the Competition Commission draws up “theories of harm” as a framework to assess whether a merger could lead to an SLC. The theories set out possible changes arising from the merger, especially how it could impact on rivalry and harm customers. For example, the theories may set out the merger candidates' offerings in areas where they compete and which could worsen as a result of the merger in terms of price, quality, product range or innovation.

Whether the merger risks an SLC is assessed by comparing these possible situations with the possible situations if the merger does not go ahead (the "counterfactual"). The counterfactual will not be the same as the current situation if change is expected in any event.

SLC is not the same test as abuse of dominance (see our Introduction to Competition Law). It is inevitably more speculative to assess - through counterfactual comparison - whether there is likely to be an SLC in the future than it is to assess whether there is an abuse of dominance now. If the arguments for and against merger are finely balanced, the existence of laws prohibiting abuse of dominance provides a safeguard, so where a proposed merger has clear efficiency benefits, the regulators can be more inclined to allow it knowing there is a regime to tackle any subsequent abuse.

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