



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

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Markets of Insufficient Importance - Consultation
Mergers Group
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX

By email

Dear Sirs

**CONSULTATION ON PROPOSED REVISION TO MERGERS - SUBSTANTIVE
ASSESSMENT GUIDANCE**

The Institute of Chartered Accountants in England and Wales ('the Institute') is pleased to respond to your request for comments on the proposed revision to *Mergers – Substantive assessment guidance* in relation to the Exception to the duty to refer: markets of insufficient importance.

Please contact Katerina Joannou, Capital Markets Policy Manager, at katerina.joannou@icaew.com or on 020 7920 8806, should you wish to discuss any of the points raised in the attached response.

Yours faithfully

Vera Sabeva
Head of Corporate Finance Faculty
T +44 (0)20 7920 8796
F +44 (0)20 7920 8784
E vera.sabeva@icaew.com



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ICAEW Representation

ICAEW REP 68/07

PROPOSED REVISION TO MERGERS - SUBSTANTIVE ASSESSMENT GUIDANCE

Memorandum of comment submitted in August 2007 by The Institute of Chartered Accountants in England and Wales, in response to the Office of Fair Trading's Consultation on proposed revision to *Mergers - Substantive assessment guidance* Exception to the duty to refer: markets of insufficient importance, published in June 2007

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales ("the Institute" or "the ICAEW") welcomes the opportunity to comment on "Consultation on proposed revision to *Mergers-Substantive assessment guidance* Exception to the duty to refer: markets of insufficient importance", published by the Office of Fair Trading (OFT).

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the initiative

4. We welcome the OFT's proposal to issue revised guidance to avoid merger referrals where the costs involved in a referral would be disproportionate to the benefits. We believe that this initiative has the potential to reduce the burden of regulation on businesses, and the cost to the taxpayer of the UK merger control regime, without compromising protection of competition and consumers.
5. However we have some specific points on the practical application of the proposals set out in the consultation paper. These are addressed in paragraphs 8–17 below.
6. We also have a number of concerns about the way the draft is formulated which could thwart the OFT's goal and limit the usefulness of the guidance to businesses and their advisers. These are set out in paragraphs 18–23 below. With appropriate revision we believe that the guidance will help reduce the number of small and inoffensive mergers that are needlessly caught up in the UK merger control regime.
7. The Government recognises that ensuring an efficient market for business transfers is important in building an enterprise culture but has noted that there are currently a number of barriers which businesses face in ensuring a smooth succession of ownership, which particularly affect smaller business¹. The ICAEW supports the Government's goal of reducing the obstacles to the transfer of businesses, and believes that the OFT's initiative has a role to play in supporting this wider policy objective. In this context, when setting the market size threshold

¹ Small Business Service "Passing the Baton - encouraging successful business transfers"

to be applied for the purposes of the small markets exception, we hope that the OFT will consider the effect that setting too low a threshold would have on the market for business transfers, and we welcome the OFT's intention to keep the size of the threshold under review in the light of the operation of the guidance.

SPECIFIC POINTS ON PRACTICAL APPLICATION

The scope of the caveat risks undermining the £10 million threshold

8. The small markets exception is potentially applicable even if the merger may create a substantial lessening of competition (SLC). The draft guidance envisages that, even in markets below £10 million, the small markets exception is less likely to apply where there is very high market concentration and low entry prospects and/or evidence of coordination. Clearly the small markets exception will only be useful if the threshold used here is significantly higher than the threshold for there to be an SLC.
9. While it remains to be seen how the OFT would apply this caveat in practice, there is a risk that its scope would undermine the usefulness of the £10 million threshold. Cases referred by the OFT under the existing policy such as Drager Medical/Air-Shields, ConvaTec/Accordis Speciality Fibres and Safenet/NCipher would all likely have fallen under the £10 million market size threshold. However in each of those cases it is at least arguable that they may have fallen within the scope of the caveat regarding very high concentration and accordingly not benefited from the small markets exception.
10. If the OFT wishes to include this caveat it should clarify that the threshold is significantly higher than would be required in an assessment of whether the merger creates a SLC.

The guidance should clarify that an SLC assessment may not be carried out if the small markets exception applies

11. We consider it would be useful if the OFT stated that it may not carry out an SLC assessment if it finds that the small markets exception applies (procedurally, the OFT could analyse the small markets exception first in cases where it considered that it might come into play). Such a clarification would help to reduce the public and private resources expended on “small market” cases.
12. This should not pose any difficulty since, if the small markets exception applies, there is no duty to refer even if there may be an SLC.

The guidance should be structured as a safe harbour

13. The key question before the OFT and advisers is when the small markets exception will, or will be likely to, apply. The draft only provides guidance as to when the small markets exception will be likely **not** to apply. Judging by paragraph 5.5 of the consultation paper, the OFT's intended interpretation is that, in the absence of the conditions set out in paragraphs 7.6 to 7.8, the small markets exception is likely to apply.
14. We believe that the guidance should set out the conditions for when the exception will apply. Accordingly the OFT should state that it is likely to consider the affected market(s) to be of insufficient importance to justify a reference where

their annual value in the UK (in aggregate) is less than £10 million. If necessary, this basic position could be made subject to caveats.

Presumes a consumer welfare standard

15. The draft guidance (paragraph 7.6) appears to presume a consumerist welfare standard for assessing the benefits of reference. Paragraph 7.7 also refers to “harm to consumers”. The appropriate welfare standard for merger control is controversial, with many eminent economists advocating a welfare standard which places weight on both producer and consumer surplus².
16. The existing substantive guidance and the relevant statute, refer to the impact of mergers on competition, rather than solely on consumers, an approach which avoids making a commitment to a particular welfare standard. This approach is, in our view, sensible.
17. Consistent with this, we recommend that the new guidance should refer (at paragraphs 7.6 and 7.7) to the impact of mergers on competition rather than consumers.

COMMENTS ON PROPOSED REVISION TO THE RELEVANT TEXT OF THE OFT SUBSTANTIVE GUIDANCE (SET OUT IN ANNEX 1)

Purpose of the exception

18. Paragraph 7.5, “The OFT may exceptionally decide not to refer...”

The term “exceptionally”, which is not in the current version of the guidelines or the statute, is probably intended to refer to the fact that the provision is an exception to the general duty, rather than the frequency with which the provision will be used. There is a danger that the term will be interpreted as suggesting that the small markets exception will apply only very rarely. Given that the OFT’s stated intention is to bring the exception into use in a larger number of cases and that it intends to remove from the guidance the suggestion that it is likely to apply only very rarely, we recommend that this term is removed.

The basis of the OFT’s approach

19. Paragraph 7.6 “The OFT is therefore most likely to exercise its discretion not to refer where the relevant market features (which will overlap with those relevant in the assessment of the substantial lessening of competition) indicate that the merger’s impact is likely to be limited, which will depend, among other things, on the market’s size and ability to self-correct within the medium to short term. The OFT is likely to consider the affected market(s) to be of significant importance to justify a reference where their annual value in the UK (in aggregate) is more than £10 million.”

A problem with this formulation is that the small markets exception is only useful if it can apply even if there may be an SLC. It could be difficult to reconcile the merger’s impact being “limited” with the possible existence of an SLC. Also as discussed in paragraph 14 above, it would be less ambiguous if the guidance is structured as a safe harbour (that is, when the exception **will** apply) rather than a

² See for example Massimo Motta *Competition Policy: Theory and Practice* (2004) and Kenneth Meyer “Welfare Standards and Merger Analysis: Why not the best?”, Department of Justice Discussion Paper

statement of when it will not (as in the draft). Accordingly, we consider that a formulation on the following lines would be preferable:

“The OFT is likely to consider the affected market(s) to be of insufficient importance to justify a reference where their annual value in the UK (in aggregate) is less than £10 million, unless the merger is severely anti-competitive. The threshold for a merger to be severely anti-competitive is significantly higher than would be used in determining whether it may result in a substantial lessening of competition.”

20. Paragraph 7.7 “The expected harm to consumers is likely to be higher, and the use of the exemption therefore less likely to be appropriate, where there is...”

We consider the following would be preferable:

“The expected impact on competition is likely to be severe, and the use of the exemption therefore less likely to be appropriate where there is...”

21. Paragraph 7.7 under the bullet point **Very high market concentration and low entry prospects**, the statement “would typically lead to large price increases” is too strong since it will hinge on a number of factors such as available substitutes, ease of entry and buyer power. We consider the following would be preferable:

“Very high market concentration and low entry prospects
A merger may be severely anti-competitive if the market is very highly concentrated and has substantial and durable barriers to entry and/or expansion. A merger is unlikely to be considered severely anti-competitive unless each merging party is the only significant competitor to the other, or one of only two.”

22. Paragraph 7.7, bullet point **Evidence of coordination**. There should be not only evidence of coordination in the market, but also that the merger would exacerbate the situation (for example, by solidifying the existing coordination).

23. Paragraph 7.8. There is a risk that the caveats on precedent value and vulnerable customers will undermine the usefulness of the £10 million threshold. If the OFT considers that the caveats cannot be eliminated then at least an indication that they will be used rarely would be helpful.

Email: katerina.ioannou@icaew.com

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