

Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance

OFT1122

This guidance was originally published by the Office of Fair Trading (OFT) and has been adopted by the CMA board. The original text has been retained unamended, therefore it does not reflect or take account of developments in case law, legislation or practice since its original publication.

Please also note:

- all references to issues of jurisdiction or procedure in mergers cases must be read in the light of [Mergers: Guidance on the CMA's jurisdiction and procedure \(CMA2\)](#); in the case of conflict, CMA2 prevails
- references to the OFT or CC (except where referring to specific past OFT or CC practice or case law) should be read as referring to the CMA
- references to 'referral to the CC' or 'a reference to the CC' should be read as the referral of a case by the CMA (or Secretary of State) for a phase 2 investigation involving an Inquiry Group of CMA panel members
- references to articles of the EC Treaty should be read as referring to the equivalent articles of the Treaty on the Functioning of the European Union
- certain OFT or CC departments, teams or individual roles may not be replicated in the CMA, or may have been renamed; the CMA's structure is set out in [our organisation chart](#)
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Mergers

Exceptions to the duty to refer and undertakings in lieu of reference guidance

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PREFACE

This guidance forms part of the advice and information published by the Office of Fair Trading (the OFT) under section 106 of the Enterprise Act 2002 (the Act). This guidance is designed to provide general information and advice to companies and their advisers on how the OFT applies the available exceptions to the duty to refer and its ability to accept undertakings in lieu of reference in operating the merger control regime set out in the Act. It should be read alongside the OFT publication *Mergers – jurisdictional and procedural guidance* (OFT527) and the OFT/Competition Commission (CC) publication *Merger assessment guidelines* (OFT1254).

This new guidance supersedes previously published information on the OFT's application of the exceptions to the duty to refer and acceptance of undertakings in lieu of reference to the CC, including chapters 7 and 8 of the OFT publication *Mergers – substantive assessment guidance* (OFT516) (as revised by *Exception to the duty to refer: markets of insufficient importance* (OFT516b), commonly known as the 'de minimis' guidance).¹

This guidance sets out the OFT's current practice (and intended future practice) as from the date of publication. This guidance reflects the views of the OFT at the time of publication and may be revised from time to time to reflect changes in best practice, legislation and the results of experience, legal judgments and research. This guidance may in due course be supplemented, revised or replaced. The OFT's web site will always display the latest version of the guidance. Where there is any difference in emphasis or detail between this guidance and other guidance produced by the OFT, the most recently published guidance takes precedence.

Although it covers most of the points likely to be of immediate concern to businesses and their advisers, this guidance makes no claim to be comprehensive. It cannot, therefore, be seen as a substitute for the Act and the regulations and orders made under the Act, nor can it be cited as a definitive

¹ As a result, *Mergers – substantive assessment guidance* (OFT516) has now been totally superseded by this guidance and the *Merger assessment guidelines* (OFT1254).

interpretation of the law. Anyone in any doubt about whether they may be affected by the legislation should consider seeking legal advice. Furthermore, although the OFT will have regard to this guidance in handling mergers under the Act, the OFT will apply this guidance flexibly and may depart from the approach described in the guidance where it is appropriate to do so.

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1 PURPOSE AND SCOPE OF THIS GUIDANCE

1.1 This guidance is published pursuant to section 106 of the Act to provide guidance to companies and their advisers on the criteria applied by the OFT when considering whether to exercise an available discretion not to refer a merger to the CC for further investigation or when considering whether to accept undertakings in lieu of reference to the CC.

1.2 Subject to the limited exceptions discussed in this guidance,² the OFT has a duty to refer a merger to the CC for investigation under section 22 or 33 of the Act, in relation to completed or anticipated mergers respectively, if it believes that it is or may be the case that:

- a relevant merger situation has been created or arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, and
- the creation of the relevant merger situation has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services.

1.3 This guidance explains how the OFT applies the discretionary exceptions to the duty to refer, namely its consideration of whether:

- the market concerned is not, or the markets concerned are not, of sufficient importance to justify the making of a reference to the CC (chapter 2)
- in the case of anticipated mergers, the arrangements concerned are not sufficiently far advanced, or are not sufficiently likely to proceed, to justify the making of a reference to the CC (chapter 3), or

² In addition, there are a number of technical reasons why a reference may not be made that are detailed in section 22(3) and section 33(3) of the Act.

- any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition concerned (chapter 4).

1.4 The OFT also provides guidance on how it will exercise its ability not to refer if it accepts undertakings in lieu of reference to the CC (chapter 5).

1.5 Under section 73(1) of the Act, the OFT has the ability to accept undertakings in lieu of reference to the CC only where it otherwise intends to make a reference (that is, where it has decided not to apply any available exceptions to the duty to refer). Given that both the duty to refer and any available exceptions to the duty to refer apply to the relevant merger situation as a whole, it is not possible to apply an exception to the duty to refer to one affected market, whilst preserving the ability to accept undertakings in lieu of reference in a different affected market.

Chapter 2 – Markets of insufficient importance ('de minimis')
– was updated and replaced by [CMA64](#) on 16 June 2017.

3 ARRANGEMENTS INSUFFICIENTLY FAR ADVANCED/ INSUFFICIENTLY LIKELY TO PROCEED

- 3.1 The intention of section 33(2)(b) of the Act is to avoid the unnecessary expense of a reference where it is still uncertain whether the parties will proceed with the merger.
- 3.2 This provision also ensures that the duty to refer is not triggered when the OFT is informed of potential transactions on a confidential basis in order for the parties to seek informal advice.³⁵
- 3.3 The OFT would usually expect a transaction to be sufficiently advanced to justify a reference where:
- the parties to a transaction have publicly announced an agreed merger or their intention to merge (in whole or in part), or
 - one of the parties to a proposed transaction has announced a possible offer or a firm intention to make an offer for the other notwithstanding that this may be subject to conditions or be a hostile bid.
- 3.4 This exception may be appropriate for use in situations where commercial discussions between the parties are still ongoing at the time of the OFT's investigation, for example in anticipated joint venture situations where there remains material ambiguity about how the joint venture will be structured.
- 3.5 In practice, and where this is justified, the OFT would take a view soon after notification as to whether a full competition analysis is not required because of the early stage of proceedings.

³⁵ The OFT is not obliged under section 107(1)(a) of the Act to publish a decision not to refer on the basis of this exception.

4 RELEVANT CUSTOMER BENEFITS

Introduction to efficiencies and relevant customer benefits under the Act

- 4.1 While mergers can harm competition, they can also give rise to efficiencies.
- 4.2 Efficiencies arising from the merger may enhance rivalry, with the result that the merger does not give rise to a substantial lessening of competition. For example, a merger of two of the smaller firms in a market resulting in efficiency gains might allow the merged entity to compete more effectively with the larger firms.
- 4.3 The Act also enables efficiencies to be taken into account in the form of relevant customer benefits. These benefits are defined in section 30(1) of the Act, and are not limited to efficiencies affecting rivalry.³⁶ In addition, the statutory definition enables the OFT to take into account benefits to customers arising in markets other than where the substantial lessening of competition is found, and benefits to future customers.
- 4.4 For the OFT, relevant customer benefits are a potential exception to the duty to refer a merger to the CC where they outweigh the substantial lessening of competition and any adverse effects of the substantial lessening of competition from the merger as a whole. It is not possible to apply an exception to the duty to refer in relation to certain affected markets, whilst accepting an undertaking in lieu in respect of other markets.³⁷ Consequently, any relevant customer benefits must outweigh

³⁶ A given efficiency may potentially be relevant either as a means of preventing a substantial lessening of competition from occurring, through its impact on rivalry in the market, or as a relevant customer benefit to the extent that it results in lower prices, higher quality, greater choice or greater innovation for customers. The relationship between efficiencies and relevant customer benefits was discussed in the Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited 23 September 2010, paragraphs 106ff.

³⁷ Sections 22(2) and 33(2) allow the OFT not to make a reference because of the application of an exception to the duty to refer. Section 73(1) allows the OFT to accept an undertaking in lieu

the substantial lessening of competition and any adverse effects of the substantial lessening of competition in all affected markets.

- 4.5 Even where the existence of relevant customer benefits is established, the OFT is exercising a discretion whether it should decide not to refer the merger in question to the CC.³⁸ In exercising this discretion, the OFT would have regard to the benefits of a CC investigation, including the possibility of remedies being obtained that sought to preserve any relevant customer benefits.³⁹

Definition of relevant customer benefits under the Act

- 4.6 Relevant customer benefits are limited by section 30(1) of the Act to be benefits to relevant customers in the form of:

- lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom, or
- greater innovation in relation to such goods or services.

- 4.7 Sections 30(2) and (3) of the Act provide that a benefit is only a relevant customer benefit if it has accrued or is expected to accrue to relevant customers within the UK within a reasonable period from the merger and would be unlikely to accrue without the merger or a similar lessening of competition. Relevant customers are customers at any point in the chain of production and distribution and are therefore not limited to final customers (section 30(4) of the Act).

where it is under a duty to make a reference, taking account of the power of the OFT under sections 22(2) and 33(2) to decide not to make such a reference.

³⁸ At the time of publication of this guidance, the relevant customer benefits exception to the duty to refer had not been used under the Act.

³⁹ See Competition Commission *Merger Remedies Guidelines* CC8, paragraphs 1.14ff.

Evidential requirements to demonstrate relevant customer benefits

- 4.8 To count as relevant customer benefits, customers need to be better off with the merger, despite the fact that the OFT believes that the merger raises the realistic prospect of a substantial lessening of competition. These will be rare cases since, ordinarily, the OFT would expect a substantial loss of competition to lead to harm to customers in the form of higher prices, lower quality, reduced service and/or reduced innovation.
- 4.9 Under section 30 of the Act, the OFT must believe that the claimed relevant customer benefits have accrued or may be expected to accrue as a result of the merger. For the OFT to consider exercising its discretion, the claimed relevant customer benefits must be clear, and the evidence in support of them must be compelling. In other words, the parties should be able to produce detailed and verifiable evidence of any anticipated price reductions or other benefits.⁴⁰
- 4.10 In deciding whether the claimed relevant customer benefits are such as to outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition, the OFT has regard both to the magnitude of the benefits and the probability of them occurring, and sets this against the scale of the identified anti-competitive effects and the probability of them occurring. The more powerful and more likely the anti-competitive effects of the merger, the greater and more likely the relevant customer benefits must be to meet and overcome such concerns.⁴¹

⁴⁰ These evidential demands in relation to the existence of relevant customer benefits reflect the OFT's status as a first-phase review body applying a discretionary exception to the duty to refer, and are analogous to the evidential requirements applicable to the existence of efficiencies that are such as to prevent a realistic prospect of a substantial lessening of competition from occurring: see paragraph 5.7.4 of the OFT/CC Merger assessment guidelines.

⁴¹ See Completed acquisition by Global Radio UK Limited of GCap Media plc 8 August 2008, paragraph 150.

4.11 The provision of evidence by the parties as to the existence of relevant customer benefits resulting from the merger in no way implies the acceptance by them of the existence of a substantial lessening of competition.

Illustrations of relevant customer benefits

4.12 It is not sufficient to demonstrate that there are merely some theoretical benefits to customers: the merging parties must also demonstrate that the parties will have the incentive to pass benefits on to customers and that these benefits will be sufficient to outweigh the adverse effect on customers arising from the substantial lessening of competition resulting from the merger. Illustrations of situations where such relevant customer benefits (as defined by the Act) might be weighed against the identified loss of competition include the following.⁴²

- Lower prices. A merger may, despite leading to a substantial lessening of competition, give clear scope for large cost savings through a reduction in marginal costs of production. In these circumstances, the merged firm – even if it is a monopolist – may therefore pass on some of this reduction in the form of lower prices to its customers such that it might outweigh the substantial lessening of competition.
- Greater innovation. A merger might, in rare cases, facilitate innovation through research and development that could only be achieved through a certain critical mass, especially where larger fixed (and) sunk costs are involved. Exceptionally, the benefits likely to be passed through to customers from such innovation might outweigh the substantial lessening of competition.

⁴² Different types of efficiencies, which may be considered in some cases as relevant customer benefits, are discussed in the OFT/CC Merger assessment guidelines paragraphs 5.7.6 to 5.7.18.

- Greater choice or higher quality. One situation in which benefits of this kind might arise is where a merger increases the size of a network, and thus its value to customers. Where services are provided over an infrastructure network, for example in public transport, an increase in the number of access points to the network may result in an increase in the value of the network to customers and may thus outweigh the substantial lessening of competition. A merger may result in enhanced network benefits through, for example, improving the reach or service provided by a network.

4.13 The claimed relevant customer benefits must accrue to customers of the merging parties (or to customers in a chain beginning with those customers), but need not necessarily arise in the market(s) where the substantial lessening of competition concerns have arisen. It is therefore conceivable that sufficient relevant customer benefits might accrue in one market as a result of the merger that would outweigh a finding of a substantial lessening of competition in another market(s).

5 UNDERTAKINGS IN LIEU OF REFERENCE TO THE COMPETITION COMMISSION⁴³

Introduction and overview

- 5.1 Where the test for reference is met and the OFT otherwise intends to make a reference,⁴⁴ section 73 of the Act allows the OFT (or the Secretary of State in public interest cases, pursuant to Schedule 7) to accept binding undertakings from the merging parties⁴⁵ as an alternative to making a reference to the CC.
- 5.2 The ability under the Act for parties to give undertakings in lieu of reference to the CC allows for transactions to be structured to allow the benign or pro-competitive part of the merger to proceed, while at the same time guarding against the acquisition of market power or an increased risk of co-ordination that harms customers in markets representing a subset of the overall transaction.
- 5.3 The merging parties may be willing to resolve the problem by offering to divest part of the merged business (structural undertakings); alternatively, in order to remove the concerns that have been raised, an acquirer may give a formal commitment about its future conduct (behavioural undertakings).

⁴³ This chapter addresses the principles that the OFT applies in determining whether to accept undertakings in lieu of reference. The procedural aspects of the undertakings in lieu process are addressed in chapter 8 of the OFT's *Mergers – jurisdictional and procedural guidance*.

⁴⁴ Section 73(1) of the Act gives the OFT the power to accept undertakings in lieu only where the OFT has concluded that the duty to refer is met and where the OFT has decided not to apply any available exceptions to the duty to refer.

⁴⁵ Section 73(2) of the Act provides the OFT with the power to accept undertakings from 'such of the parties concerned as it considers appropriate'. The Act does not give the OFT the power to accept undertakings from unconcerned third parties.

- 5.4 However, it is always at the parties' discretion, faced with the prospect of reference, as to whether to choose to offer undertakings in lieu in such a case, or to pursue their case afresh at the CC. The OFT cannot impose a first-phase remedy via an order⁴⁶ (as can the CC in appropriate second-phase cases).
- 5.5 The procedures concerning the offering of undertakings in lieu are set out in detail in the OFT's *Mergers – jurisdictional and procedural guidance*.⁴⁷ The OFT sets out in this chapter the substantive principles it applies in determining whether to suspend its duty to refer and subsequently to accept undertakings in lieu in a particular case.

The clear-cut standard for undertakings in lieu

- 5.6 In order to accept undertakings in lieu of reference, the OFT must be confident that all the potential competition concerns that have been identified in its investigation would be resolved by means of the undertakings in lieu without the need for further investigation. The need for confidence reflects the fact that, once undertakings in lieu have been accepted, this is final in terms of the OFT's ability to refer, as section 74(1) of the Act precludes a reference after that point.
- 5.7 Undertakings in lieu of reference are therefore appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut. Furthermore, those remedies must be capable of ready implementation.
- 5.8 The clear-cut requirement has two separate dimensions.
- First, in relation to the substantive competition assessment, it means that there must not be material doubts about the overall

⁴⁶ Unless the OFT has previously accepted undertakings in lieu and, for example, those undertakings are not being or will not be fulfilled, in which case the OFT gains order-making powers under section 75 of the Act.

⁴⁷ See paragraphs 8.8 to 8.12 of the OFT's *Mergers – jurisdictional and procedural guidance*.

effectiveness of the remedy. The more extensive the competition concerns in question in terms of magnitude of potential customer harm, the more significant the error costs of an ineffective remedy may be, and hence the greater the belief must be on the part of the OFT that the undertakings comprehensively resolve those concerns. Whilst the OFT will require that the clear-cut standard is applied to any remedy where the test for reference has been met, in those cases where the potential magnitude of harm is especially large (in absolute terms), the OFT will be particularly cautious in its approach to accepting undertakings in lieu.

- Second, in practical terms, it means that an undertakings package that is of such magnitude in absolute terms and/or complexity that its implementation would require unworkable resources at first phase will not be accepted. This practical requirement, in terms of assessment and implementation, may impact on the specifications of a divestment package in order to ensure it remains practicable.⁴⁸

5.9 In some cases, it may be at the end of the OFT's investigation that there remains some doubt over the precise nature or likelihood of the substantial lessening of competition even though the test for reference is met.⁴⁹ For example, it may be that the OFT cannot dismiss concerns based on each of unilateral effects and co-ordinated effects. This doubt may include uncertainty as to exactly how any merger effect would be likely to be felt. This in itself will not exclude the possibility of undertakings in lieu being acceptable. The question for the OFT is whether the remedy proposed would act in a clear-cut manner to remove

⁴⁸ For example in the undertakings given by Boots Group plc in relation to its acquisition of Alliance UniChem PLC 25 May 2006, and in those given by Co-operative Group Limited in relation to its acquisition of Somerfield Limited 15 January 2009, the OFT required that the 96 pharmacy stores and 109 non-upfront buyer grocery stores respectively be divested in no more than 25 packages.

⁴⁹ Reflecting the fact that the OFT's test for reference is whether there is a realistic prospect of a substantial lessening of competition, rather than establishing a substantial lessening of competition on the balance of probabilities.

all competition concerns meeting the test for reference caused by the merger.

Restoration of competition

- 5.10 Section 73(2) of the Act provides the OFT with the ability to accept undertakings in lieu 'for the purpose of remedying, mitigating or preventing' competition concerns. At the same time, the Act refers to the obligation on the OFT 'to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable' (section 73(3)).
- 5.11 The OFT's starting point is to seek an outcome that restores competition to the level that would have prevailed absent the merger (described here for simplicity as pre-merger levels), thereby comprehensively remedying the substantial lessening of competition.⁵⁰ The objective is to ensure that competition following the implementation of the remedy is as effective as pre-merger competition. However, this is without prejudice in any given case to the ability of the parties to persuade the OFT that a proposed remedy that does not directly restore competition to pre-merger levels nevertheless clearly and comprehensively removes the substantial lessening of competition identified.
- 5.12 As a general rule, and in line with the OFT's starting point detailed above, the OFT considers that it is appropriate for it to seek to remedy or prevent competition concerns, rather than accepting remedies that simply mitigate concerns. The OFT is mindful that the CC has significant remedy powers under Schedule 8 of the Act. The OFT would therefore be extremely cautious before accepting a purely mitigatory remedy, and would be very unlikely to do so save where it was abundantly clear that the CC (notwithstanding its order-making powers, ability actually to

⁵⁰ See *Co-operative Group (CWS) Limited v OFT* [2007] CAT 24, paragraphs 149 to 151, where the CAT considered it was not unreasonable for the OFT to adopt as its starting point the objective of restoring competition to pre-merger levels and, in the particular circumstances of that case, to seek to ensure that competition was restored to pre-merger levels.

prohibit a merger and the increased time available in the context of a second-phase inquiry to consider more detailed remedies) would be materially no better placed than the OFT to achieve a remedy that would restore the levels of competition that existed pre-merger.⁵¹

- 5.13 In line with section 73(4) of the Act, the OFT may have regard to the effect of any undertakings in lieu in relation to any relevant customer benefits. In practice, this means that where there is a choice of two undertakings in lieu offers that are equally effective in terms of remedying the substantial lessening of competition identified, the OFT will prefer the remedy that preserves any relevant customer benefits. However, the OFT will not accept undertakings in lieu of reference that do not address the identified competition effects but which are designed instead to 'lock in' sufficient customer benefits to outweigh the risks of a substantial lessening of competition arising.

Proportionality of undertakings in lieu

- 5.14 The OFT is required under section 73(3) of the Act, in accepting undertakings in lieu, to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition it has found and any adverse effects resulting from it. In considering undertakings in lieu, the OFT will therefore seek to achieve a remedy that clearly addresses the identified adverse competition effects.

⁵¹ In its decision accepting the proposed undertakings in lieu in the Anticipated acquisition by Co-operative Group Limited of Somerfield Limited 15 January 2009, the OFT stated that it approved a purchaser for one store, notwithstanding that it was a grocery retailer from outside the effective competitor set (as defined in the decision), given the demonstrable absence of any purchaser from within the effective competitor set. Approving that purchaser provided the most satisfactory and comprehensive means of restoring competition to pre-merger levels. The OFT stated that its decision was influenced by the fact that, were the merger to be referred to the CC, the CC would be no better placed than the OFT to identify an effective purchaser to resolve competition concerns in that local area.

- 5.15 At the same time, the Act is clear that the purpose of the undertakings in lieu must be to remedy, mitigate or prevent the substantial lessening of competition concerned or any adverse effect which has or may have resulted from the merger or may be expected to result from it. It is therefore incumbent on the OFT to ensure that any undertakings in lieu are proportionate to the concerns identified in its decision. The scope of the undertakings in lieu should not go beyond what is necessary in order to remedy identified competition concerns in any particular case.
- 5.16 When presented with a range of alternative remedy options from merging parties, the OFT will therefore select only the particular option or options that are necessary in order to remedy comprehensively the concerns that have been identified. Offers that have been made by the parties that go beyond what is necessary are 'left on the table'.⁵² In practical terms:
- the OFT will not take remedy offers that relate specifically to a particular market where it does not find concerns in that market, and
 - the OFT will not take remedy options where, even where it has found concerns in a market, these concerns are remedied equally effectively by an alternative, less-intrusive remedy that has been offered by the parties.

For this reason, parties may wish to offer a range of alternative remedies that they would be prepared to give in order to avoid a reference to the CC.⁵³

- 5.17 The OFT's obligation to accept undertakings only in so far as they are necessary to remedy its competition concerns does not mean that it will take a less effective remedy simply because its belief in the likelihood of

⁵² This has occurred in a number of cases, for example Completed acquisition by Home Retail Group plc of 27 leasehold properties from Focus (DIY) Ltd 15 April 2008, paragraph 136.

⁵³ See paragraph 8.16 of the OFT *Mergers – jurisdictional and procedural guidance*.

substantial lessening of competition is lower than in other cases. To the extent the duty to refer is met (that is, there is a realistic prospect of a substantial lessening of competition), any undertakings in lieu must remedy the concerns identified to the clear-cut standard. The OFT accepts that it may therefore require a greater set of remedies than might ultimately be needed if the merger were to receive a detailed, second-phase investigation by the CC. This arises from the fact that the OFT is under a duty to refer where it believes that 'it is or may be the case that' a merger has resulted or may be expected to result in a substantial lessening of competition.⁵⁴ In such cases, it is indeed possible that, after a detailed examination, the CC may not find that a substantial lessening of competition may be expected to occur on the balance of probabilities (that is, such that no remedy is required at all).

- 5.18 To the extent that parties are not prepared to provide a remedy in all situations where the test for reference is met (including on the 'may be the case' standard), then they retain the choice to have their case examined in detail at the CC stage.
- 5.19 The OFT's obligation, in terms of proportionality, is to accept undertakings only in so far as they are needed to remedy the competition concerns it has identified and to select the least intrusive remedy where there is a choice of equally effective remedies. The OFT has no responsibility for ensuring that any undertakings offered and accepted are proportionate, in a commercial sense, in terms of the wider transaction. The voluntary nature of the undertakings in lieu process at the OFT stage means that proportionality of divestments in terms of overall transaction value is a commercial matter for the parties and is not an issue for determination by the OFT. As a matter of principle, the OFT will therefore not reject an offer of undertakings on the basis that it

⁵⁴ See for example Anticipated acquisition by Boots plc of Alliance UniChem plc 6 February 2006, paragraph 82, in which the OFT took the view that 'it may be the case that' the merger may be expected to result in a substantial lessening of competition in '3 to 2' pharmacy overlap areas, and these areas were covered by the parties' undertakings in lieu offer and accepted by the OFT.

forms too great a proportion of the wider transaction and would, in principle, be prepared to accept the abandoning or complete unwinding of a transaction if this were offered by the parties.⁵⁵

Structural undertakings

- 5.20 A merger involves a structural change to a market. A structural solution will therefore normally be the most appropriate remedy if the OFT believes that it is or may be the case that a merger has resulted or may be expected to result in a substantial lessening of competition. The OFT is more likely to accept structural undertakings as undertakings in lieu than behavioural undertakings because they address the change to the market structure that gives rise to the competition concerns.
- 5.21 Typically, structural undertakings require the sale of one of the overlapping businesses. These should be capable of being fully separated from the merging parties.
- 5.22 In terms of choice of divestment business (that is, which of the acquired business or the acquiring business should be divested), the OFT's starting point will often be to require divestment of the business that has been acquired.⁵⁶ However, the OFT will also consider divestment of the buyer's existing business (or part of it) as an alternative, although in such cases the OFT will also need to consider the competition implications of the asset swap and will need to be sure that the divestiture of the buyer's existing business is a suitable remedy in terms

⁵⁵ However, for the purposes of determining whether clear-cut undertakings in lieu are 'in principle' available as part of a 'de minimis' assessment, the OFT will not take account of a hypothetical remedy that would amount to the prohibition of a transaction (see paragraph 2.25 above) and will have regard to the proportionality of the remedy (see paragraph 2.26).

⁵⁶ See *Somerfield PLC v Competition Commission* [2006] CAT 4, paragraph 99, where the CAT confirmed that it was reasonable for the CC, as a starting point, to consider that restoring the *status quo ante* would normally involve reversing the completed acquisition unless the contrary were shown.

of its saleability.⁵⁷ In appropriate cases, the OFT may be willing to leave open to the merging parties which of the overlapping businesses they wish to sell, with the undertakings stipulating that one of them must be sold.⁵⁸

- 5.23 In certain cases, contractual provisions such as purchase or supply arrangements between the seller and the purchaser may be necessary to support a structural divestment on an interim basis, although it will be relatively rare that this is the case given the requirement at the OFT stage for a divestment to act as a clear-cut remedy. For example, the OFT has required merging parties to enter into a short-term interim purchase contract in relation to a divested business in order to provide the purchaser with initial guaranteed minimum volumes.⁵⁹
- 5.24 In appropriate cases, the OFT will consider other structural or quasi-structural undertakings in lieu of reference. A structural remedy other than divestiture might comprise an amendment to intellectual property licences, for example so as to grant a divestment purchaser a perpetual and royalty-free licence.⁶⁰

⁵⁷ The OFT will (in line with statements of the CAT in *Somerfield PLC v Competition Commission*, paragraph 114) not seek to prevent an acquirer from 'trading up' by selling its own business, but will consider whether a sale of the acquirer's own business raises its own competition concerns or issues of achievability of divestment.

⁵⁸ For example, see the Undertakings given by Co-operative Group Limited in relation to the Completed merger between Co-operative Group Limited and Lothian Borders and Angus Co-operative Society Limited 14 May 2009.

⁵⁹ See paragraph 3.1 of the Undertakings given to the OFT by SRCL Limited and Cliniserve Holdings Limited 31 March 2009. See also paragraph 4 of the Undertakings provided to the OFT by Global Radio UK Limited 1 July 2009.

⁶⁰ See Anticipated acquisition by Tetra Laval Group of part of Carlisle Process Systems 20 November 2006, in which the OFT subsequently accepted a remedy focused on an irrevocable and perpetual licence of certain intellectual property rights.

Purchaser approval in structural undertakings cases

- 5.25 The OFT requires as part of its undertakings in lieu requirements in divestment cases that it should have the right to approve in advance the buyer of the divestment assets or business.⁶¹ This is to ensure that the proposed buyer is independent of the parties and has the necessary expertise, resources, incentives and intention to operate the divested business as an effective competitor in the marketplace.
- 5.26 In all cases, the evidential burden is on the merging parties (generally with the co-operation of the proposed purchaser(s)) to satisfy the OFT that its standard purchaser approval criteria are met. These are that:
- acquisition by the proposed purchaser remedies, mitigates or prevents the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it, or may be expected to result from it, in particular, having regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it
 - the proposed purchaser is independent of and unconnected to the merging parties (which will generally include an absence of financial, ownership, management and personal links between the merging parties and the proposed purchaser⁶²)
 - the proposed purchaser has the financial resources, expertise (including the managerial, operational and technical capability), incentive and intention to maintain and operate the relevant business

⁶¹ As discussed below, the stage of the process at which the OFT will consider the suitability of the purchaser will vary depending on whether the OFT has sought an upfront buyer requirement.

⁶² See Co-Operative Group (CWS) Limited v OFT, paragraph 195.

as part of a viable and active business⁶³ in competition with the merged party and other competitors in the relevant market⁶⁴

- the proposed purchaser is reasonably to be expected to obtain all necessary approvals, licences and consents from any regulatory or other authority,⁶⁵ and
- the acquisition by the proposed purchaser does not itself create a realistic prospect of a substantial lessening of competition within any market or markets in the UK.⁶⁶

5.27 If any of these criteria is not satisfied to the clear-cut standard required by the OFT, the proposed divestment would not be an effective remedy. In making its assessment of whether a purchaser fulfils these requirements, the OFT will carefully examine the information provided to it by the merging parties (and potential purchasers) and will carry out a proportionate amount of analysis and investigation, potentially including consulting informally with targeted market participants where this would be informative. However, this does not mean that the OFT will carry out

⁶³ The OFT will routinely ask to see the proposed purchaser's annual accounts and business plan for the proposed purchase in assessing whether this criterion is satisfied.

⁶⁴ The OFT will normally require the selling merging party to require from the divestment purchaser a warranty reflecting this obligation, or a variant of it, in its sale and purchase documentation (see for example paragraphs 2.6 and 3.6 of the undertakings given by the Co-Operative Group Limited to the OFT 15 January 2009 and paragraph 2.6 of the undertakings given by SRCL Limited and Cliniserve Holdings Limited to the OFT 31 March 2009).

⁶⁵ This is because the OFT wishes to be satisfied that the divestment to the proposed purchaser will in fact go ahead. To the extent that a divestment would face difficulties in obtaining such consents, this may call into question the clear-cut nature of the undertakings in lieu.

⁶⁶ The OFT would not be prepared to approve a divestment purchaser that remedied a competition problem from the original acquisition in one market, but that also created the risk of a competition problem in the same or a different market, regardless of whether or not any competition concerns created by the divestment could independently be reviewed as a separate relevant merger situation under the Act.

a detailed investigation of the type carried out for its substantial lessening of competition assessment in reaching a decision for the purposes of its purchaser approval process.⁶⁷ Where a purchaser cannot be approved as suitable without a detailed investigation, the purchaser will be rejected.

- 5.28 In requiring that the proposed purchaser be independent of and unconnected to the merging parties, the OFT will pay close attention to any links that would exist between the merging parties and the purchaser following divestment. This includes any proprietary interest that the merging parties would retain in or over the divested business that could impede the successful, independent operation of the divested business.⁶⁸ As considered in paragraph 5.23 above, in certain cases, the OFT may require specific contractual provisions in order to ensure the remedy is effective.
- 5.29 In terms of determining whether the proposed purchaser has the financial resources, expertise, incentive and intention to maintain and operate the divestment business, the OFT's consideration of the suitability of the purchaser is made at the time that the purchaser is proposed by the merging parties. In assessing a purchaser, the OFT is seeking to approve an entity that will compete vigorously in future on the basis of what it has acquired as part of the structural undertaking. The OFT will consider carefully the evidential basis on which the merging

⁶⁷ See Co-operative Group (CWS) Limited v OFT, paragraph 179.

⁶⁸ The OFT may require that such links be severed or otherwise addressed as part of the undertaking. See paragraph 2.5 of the Undertakings given by SRCL Limited and Cliniserve Holdings Limited to the OFT 31 March 2009 and paragraph 10.2 of the Undertakings given by Co-operative Group Limited to OFT in relation to its acquisition of Plymouth and South West Co-operative Limited 26 March 2010.

parties (and the proposed purchaser) assert that the proposed purchaser will have an incentive to compete going forward.⁶⁹

- 5.30 On the basis that the OFT will approve a divestment purchaser only where it is confident that the acquisition by that proposed purchaser does not itself create a realistic prospect of a substantial lessening of competition within any market or markets in the UK, the OFT would not expect to investigate the onsale divestment on its own initiative (that is it would not generally call this merger in for investigation by means of an enquiry letter). This is regardless of whether or not the onsale divestment constitutes a relevant merger situation under the Act.⁷⁰

Use of an upfront buyer

- 5.31 Once undertakings in lieu have been formally accepted by the OFT, the OFT is no longer under a duty (and is no longer able) to refer the merger to the CC (pursuant to section 74(1) of the Act). Its ability to ensure that the substantial lessening of competition identified in the original transaction is remedied is limited to enforcement of the undertakings in lieu that it has accepted (failing fulfilment of which, it may issue an order under section 75 of the Act).
- 5.32 For this reason, the OFT may seek an upfront buyer for divestments before accepting undertakings in lieu. This involves the OFT suspending its duty to refer on the basis that it will accept the undertakings in lieu

⁶⁹ The OFT will scrutinise the purchaser's incentives particularly carefully in a situation in which the purchaser is paying no compensation for the divested assets or business or a price that is materially below market value.

⁷⁰ See paragraph 8.41 of the OFT *Mergers – jurisdictional and procedural guidance*. This would not absolve the divestment purchaser from making any necessary merger control filings outside the UK.

only once divestments have been agreed with an upfront buyer (or upfront buyers) provisionally approved by the OFT.⁷¹

- 5.33 The OFT will seek an upfront buyer where the risk profile of the remedy requires it, for example where the OFT has reasonable doubts with regard to the ongoing viability of the divestment package and/or there is only a small number of candidate suitable purchasers for the divestment business that would remedy the competition concerns. Such doubts may arise, for example, because there are questions about the commercial attractiveness of the divestment business in question (most obviously where the on-sale business is only marginally profitable or is unprofitable) or where the field of suitable potential candidate purchasers is very limited.⁷² Although the OFT will generally provide in its undertakings in lieu for the appointment of a divestment trustee to sell the assets at no minimum price in the event that the parties do not achieve a sale within the stated divestment period, this ability is of limited benefit if there are simply no interested suitable purchasers.
- 5.34 The use of an upfront buyer mechanism brings several advantages in reducing the risk of an unsuccessful remedy from the OFT's perspective.
- First, to the extent that the merging parties are unable to identify a suitable purchaser or purchasers, the OFT is able to reactivate its duty to refer and to send the merger to the CC, which enjoys

⁷¹ In this upfront buyer scenario, the OFT will require that the merging parties enter into a legally binding sale agreement with the identified divestment purchaser which is conditional only on formal OFT approval of the purchaser and acceptance of the undertakings in lieu (and the completion of the main transaction if it remains anticipated). See paragraph 8.32 of the OFT *Mergers – jurisdictional and procedural guidance*.

⁷² See for example Completed acquisition by Sports Direct International plc of a number of stores from JJB Sports plc 1 May 2009. In assessing the need for an upfront buyer, the OFT will often consider the number of potential purchasers that could reasonably be expected to be able and willing to acquire the divestment business.

enhanced remedy powers, ideally within a relatively short period of time from its original decision.⁷³

- Second, the OFT is able to consult publicly on the identity and suitability of the proposed purchaser or purchasers prior to accepting the undertakings in lieu. In cases where the identity of the purchaser is particularly important to the success of the divestment remedy (for example in cases where the purchaser will need to call on its own existing expertise to exploit the divestment business) this factor can be of particular importance. The OFT is more likely to be confident to approve such a purchaser in cases where third parties have been formally given an opportunity to comment on that proposed purchaser.
- Third, use of an upfront buyer mechanism helps to align the interests of the parties with those of the OFT and customers. The parties are motivated to achieve a sale swiftly in order to end their exposure to the possibility of a reference. The OFT is keen for a swift sale to be achieved in order to minimise risks around deterioration of the business to be sold, and to avoid a continuation of the substantial lessening of competition in the market to the extent that the merger is completed.
- Fourth, the certainty provided for by the upfront buyer mechanism may provide latitude for exploration of a remedy option that the OFT would not feel confident accepting in a non-upfront context. For example, certainty around saleability becomes less important where the OFT retains the ability to refer should a suitable purchaser not be found within a limited, specified period. For this reason, the OFT is likely to be less prescriptive where an upfront buyer is used, and use of an upfront buyer may provide merging parties with greater

⁷³ See Completed acquisition by Tesco plc of the Co-operative Group (CWS) Ltd store at Uxbridge Road, Slough 19 April 2007 and Completed acquisition by Sports Direct International plc of a number of stores from JJB Sports plc 7 August 2009.

flexibility in determining, for example, which of the overlapping businesses they wish to sell.

- 5.35 From the perspective of the merging parties, the upfront buyer mechanism provides them with the ability to terminate divestment discussions and argue their case before the CC where they experience difficulty in agreeing satisfactory commercial terms with a potential divestment purchaser.⁷⁴
- 5.36 In assessing the risk profile of the remedy, the OFT will take all the relevant circumstances of the case into account, potentially including the size of the affected market and the scale of the customer harm that would occur if the substantial lessening of competition materialised. The OFT is mindful of the burden that imposition of an upfront buyer requirement places on the parties and the need for proportionality in the use of this mechanism. It is therefore less likely to require an upfront buyer where the size of the affected market is small and the scale of the potential harm is limited.⁷⁵
- 5.37 In cases involving the divestment of multiple discrete assets or businesses, of which only a minority raise divestment risks justifying the use of an upfront buyer, the OFT may consider requiring a partial upfront buyer solution. In this situation, the parties may be required to sell to an upfront buyer those assets or businesses that raise concerns of the type listed in paragraph 5.33 above, whilst the OFT will permit the remainder of the assets or businesses to be sold following acceptance of the undertakings in lieu.⁷⁶ Although not suitable in every situation, the OFT

⁷⁴ This should be contrasted with a situation where undertakings in lieu have been accepted given that those undertakings will typically provide for divestment in these circumstances, even at no minimum price.

⁷⁵ See Completed acquisition by General Healthcare Group of control of four Abbey hospitals and de facto control over Transform Holdings Limited, previously part of the Covenant Healthcare Group 14 September 2010, paragraph 125.

⁷⁶ See Anticipated acquisition by Co-operative Group Limited of Somerfield Limited 20 October 2008, where the OFT required divestment to an upfront buyer only in relation to those stores in

considers that the use of a partial upfront buyer solution may operate as a proportionate mechanism to address divestment concerns in some cases.

Behavioural undertakings

- 5.38 Behavioural undertakings provide a means of moderating the scope for a merged company to behave anti-competitively by controlling outcomes, but they do not directly address the structural consequences of the merger.
- 5.39 The OFT is generally unlikely to consider that behavioural undertakings will be sufficiently clear cut to address the identified competition concerns.
- 5.40 Behavioural remedies may bring a number of risks which can reduce their effectiveness or create competition concerns elsewhere. For example, some behavioural remedies may increase price transparency and make it easier for competitors to collude or coordinate. They can also distort investment decisions and ossify business processes.
- 5.41 In terms of monitoring and enforceability, behavioural remedies can raise significant concerns: it is difficult to design them so as to ensure that there are no loopholes and, even if this is achieved, circumvention can go undetected. Monitoring behavioural remedies may impose significant costs on private parties as well as the regulatory body concerned.⁷⁷
- 5.42 The OFT's cautious approach towards considering behavioural remedies reflects its previous experience of the difficulty of devising a workable and effective set of behavioural commitments within the context of a short, first-phase timetable. It also reflects the OFT's role as a first-

which there were expected to be a limited number of potential effective purchasers (paragraph 194).

⁷⁷ The OFT may require in the undertakings the ability to appoint a monitoring trustee in cases involving behavioural remedies.

phase review body with an obligation under the Act to have regard when accepting undertakings in lieu of reference to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it (section 73(3) of the Act).

- 5.43 Nevertheless, despite its preference for structural remedies, the OFT does not inevitably refuse behavioural remedy offers. In particular, the OFT will consider behavioural undertakings where it considers that divestment would be clearly impractical or is otherwise unavailable. Mergers raising vertical concerns are potentially more suitable to some form of behavioural undertaking, as are mergers taking place in markets in which there already exists a significant degree of regulation.⁷⁸

Undertakings in lieu in public interest cases

- 5.44 In public interest cases, which fall to the Secretary of State for decision, the OFT considers whether the competition issues that arise are such that the OFT would recommend a reference if there were no public interest issues. If the OFT would recommend a reference, the OFT will consider under section 44(4)(f) of the Act whether or not these concerns could be resolved by undertakings in lieu and will advise the Secretary of State accordingly. To the extent that merging parties make it clear that they are not prepared to offer undertakings in lieu, the OFT is likely to advise that it would not be appropriate to deal with the competition concerns arising from the merger situation by way of undertakings under paragraph 3 of Schedule 7 to the Act.⁷⁹

⁷⁸ The OFT has accepted behavioural undertakings in lieu to resolve competition concerns in only two cases under the Act, namely: Completed acquisition by IVAX International GmbH of 3M Company's distribution business for certain asthma products 20 October 2003 (the first undertakings in lieu case under the Act), and Completed acquisition by Arriva Plc of the Wales and Borders Rail franchise 16 March 2004.

⁷⁹ See Anticipated acquisition by Lloyds TSB plc of HBOS plc Report to the Secretary of State for Business Enterprise and Regulatory Reform 24 October 2008, paragraph 381.

- 5.45 The Secretary of State must have regard to the OFT's view on competition issues, but may decide that public interest issues require a different outcome to that which would occur if there were no such competition issues. This could include a decision to clear the merger, a decision to make a reference, or a decision to accept undertakings, which might be different from those proposed by the OFT to resolve any competition concerns (see chapter 9 of the OFT *Mergers – jurisdictional and procedural guidance* for a full description of public interest cases).

Remedies for breach of undertakings in lieu

- 5.46 Once undertakings in lieu have been accepted, the OFT is released from its duty to refer by section 74(1) of the Act. Undertakings in lieu therefore become the definitive solution to any substantial lessening of competition. Section 74(1) of the Act precludes a reference to the CC even where undertakings are not fulfilled. In that situation, the OFT must rely on its order-making power under section 75 of the Act and, if necessary, invoke civil proceedings under section 94 of the Act to enforce the undertakings and/or the order.
- 5.47 Under section 94 of the Act, third parties have the right to bring an action for breach of statutory duty against a party to an undertaking where the third party has suffered loss or damage as a result of the undertaking party's non-compliance. It is in part for this reason that it is important that the terms of undertakings in lieu are clear and straightforward to assist with their enforceability.

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