CMA CONSULTATION ON GUIDANCE ON INITIAL ENFORCEMENT ORDERS: RESPONSE OF CLIFFORD CHANCE LLP

1. INTRODUCTION

1.1 Clifford Chance welcomes the opportunity to comment on the Consultation Document of the Competition and Markets Authority (**CMA**) regarding the proposed guidance on Initial Enforcement Orders (**IEOs**). This response is not confidential and may be published as is.

1.2 We welcome the proposed guidance. In particular, the section of the guidance dealing with the types of derogations that the CMA is likely to grant and the circumstances in which it will do so (along with references to relevant case-specific IEOs) is extremely useful, and is likely to contribute significantly to more efficient engagement on derogations between merging parties and the CMA.

1.3 Our comments on specific sections of the draft guidance are set out below. Our one overarching observation is that the guidance might be more effective if it were integrated into the guidance on interim measures that is contained in Annexe C to the Guidance on the CMA's jurisdiction and procedure (**CMA2**). A number of the paragraphs of the draft guidance do no more than repeat the content of CMA2 (e.g. paragraphs 2.11 and 2.12). In contrast, certain important pieces of guidance that are contained in CMA2 – such as the guidance in the circumstances in which the CMA will consider requiring a monitoring trustee or hold separate manager - are not replicated in the proposed standalone guidance. A unified guidance document would avoid these duplications and omissions.

2. COMMENTS ON THE TEXT OF THE GUIDANCE

Use of IEOs in anticipated mergers

2.1 While the CMA has not, to date, prohibited closing through the use of a Phase 1 IEO, the possibility of such a prohibition has, in our experience, become an important issue in contractual negotiations regarding the allocation of antitrust risk between merging parties. Consequently, further guidance on the circumstances in which a prohibition on closing might be imposed, and the steps that parties can take to avoid such an order, would be extremely valuable (in this respect, paragraph 2.9 does not contain any additional substantive guidance beyond that which is already in CMA2). In particular:

2.1.1 are there scenarios other than asset sales in which such a prohibition may be imposed (e.g. where important customer or supplier contracts are likely to be terminated through change of control provisions)?

2.1.2 where key staff, management capability or other important assets are not being acquired, can the risk of a prohibition be mitigated by ensuring that those staff are available on secondment for a suitable period, or through appropriate transitional services arrangements?

Monitoring trustee and hold separate managers

2.2 As noted above, we consider that the draft guidance could usefully contain more information on the circumstances in which the CMA will require a monitoring trustee or hold-separate manager, drawing on the guidance in CMA2, as well as the CMA's experience of administering IEOs since CMA2 was published. In particular, the CMA might consider outlining specific positive steps (other than avoiding breaches of the IEO) that merging parties can take to reassure the CMA that the appointment of a monitoring trustee or hold separate manager is unnecessary.

Use of IEOs in completed mergers

2.3 Paragraph 2.11 refers to the CMA's power under s.72(3B) of the Enterprise Act 2002 (**EA02**) to order the unwinding of integration that has already taken place. In this respect, the draft guidance might usefully explain a point which lacks clarity in the CMA2 guidance on jurisdiction and procedure, namely the distinction between the "unavoidable consequential effects" of integration that has already taken place by the time the IEO is imposed - which would therefore fall outside the scope of the IEO unless it includes an unwinding order under s.72(3B) – and situations where the "parties could, rather than continuing with an existing integrated practice, instead operate such practices separately with the resources available at the acquired party",[1] in which the effect of the IEO will be to require the integrated practice to cease.

2.4 The example given in CMA2 of separate negotiations instead of joint negotiations does little to illustrate this distinction and does not explain how the example of integrated negotiating teams differs from the integration of sales functions that is stated in paragraph C.38 of CMA2 as being something that could only be unwound by an unwinding order under s.72(3B). Accordingly, we suggest that the guidance includes a clearer explanation of the circumstances in which an IEO requires the cessation of conduct that has already been integrated, by reference to clear and objective criteria, such as the existence of physical or legal changes that have already taken place.

2.5 Paragraph 2.15 states that the CMA will only be able to reach a view on a derogation request where sufficient time and information are available, with footnote 10 clarifying that the CMA "*is likely to require a well-developed understanding of the merging parties, the product and geographic markets affected by the merger, the potential substantive issues, the likely practical consequences of the standard IEO and/or any additional other factors that may be relevant to an assessment of the risk of pre-emptive action* […]". We consider that in many cases at least some of this information will not be necessary to allow the CMA to form a view. For instance, a well developed understanding of potential substantive competition issues is unlikely to be relevant to a derogation allowing the provision of certain back-office support services to the target. We therefore suggest that the statement refers instead to the possibility that the CMA may require all or some of that information, depending on the circumstances and the type of derogation sought.

[1] CMA2, footnote 354.

Derogations that are likely to be granted

Exclusion of necessary information flows

2.6 Paragraph 3.8 explains that the standard form IEO template states that passing of confidential or proprietary information from target to acquirer is not prohibited "where strictly necessary in the ordinary course of business (for example, where required for compliance with external regulatory and/or accounting obligations)" [emphasis added]. However, paragraph 3.10 appears to imply that compliance with external regulatory obligations is the only circumstance in which such disclosure will be considered to be necessary in the ordinary course of business, in which case the IEO template should be amended accordingly.

Conduct outside the UK

2.7 Paragraphs 3.24-3.26 deal with derogations where the parties have business operations outside the UK, with no relevance to their relevant activities in the UK. However, rather than requiring the parties to seek derogations before they integrate such activities, a better approach is to design the IEO template to ensure that such operations fall outside its scope in the first place. This would be consistent with the CMA's statutory powers: s.72 EA02 provides that IEOs can only be imposed for the purpose of preventing pre-emptive action, which cannot be the case in respect of foreign operations that have no connection with the UK. It would also be consistent with the CMA's past practice. For example in Vtech/Leapfrog, the application of the IEO to the US company LeapFrog Enterprises was limited "the business of Leapfrog and its subsidiaries carried on in the UK as at the Commencement Date" [emphasis added]. In contrast, in ProStrakan Group/Archimedes Pharma, the IEO was applied to the UK legal entity Prostrakan plc, but not to its Japanese parent company Kyowa Hakko Kirin.

2.8 We therefore submit that the guidance could usefully explain that the CMA will typically aim to limit the scope of the IEO to the business of the parties that is carried on in the UK unless there is clear evidence that their UK business operations form an indivisible part of a foreign business. It should also indicate the circumstances in which it will adopt one of the two approaches adopted in Vtech/Leapfrog and ProStrakan Group/Archimedes Pharma. In this respect, a reference to the restrictions on the application of IEOs to conduct outside the UK imposed by s.86 EA02 would also be helpful, perhaps with reference to the Court of Appeal judgment in Akzo Nobel on the interpretation of s.86.[2]

Staff retention

2.9 Paragraph 3.29 of the draft guidance states that a derogation allowing replacement of a target's staff will typically only be allowed if the parties can show "why these employees intend to leave, or have left, the target company" and footnote 27 goes on to say that "[i]n some cases, the CMA may also require merging parties to provide (or show evidence that they provided) suitable incentives in order to retain remaining key staff." An obligation to offer "suitable incentives" risks being interpreted by staff as a legal obligation to increase their remuneration if they threaten to leave, which is likely

[2] Akzo Nobel N.V. v Competition Commission & Ors [2014] EWCA Civ 482 judgment of 14 April 2014.

to have counterproductive effects on the operation of the target business. We therefore suggest that this footnote adheres more closely to the wording of the template IEO, which requires instead that "all reasonable steps are taken to encourage all key staff to remain".

Clifford Chance LLP
April 2017