Review of the use of the Merger Notice and Initial Enforcement Orders

Findings and recommendations

Summary

1. In its 2015/16 Annual Plan, the Competition and Markets Authority (CMA) undertook to review the use of the Merger Notice (Merger Notice) and Initial Enforcement Orders (IEOs) in phase 1 merger control.[1] This paper sets out the findings and recommendations resulting from this review.

Merger Notice

2. The Enterprise and Regulatory Reform Act 2013 (ERRA13) introduced a series of reforms intended to strengthen and streamline the merger control regime.[2] The CMA updated its guidance on merger control jurisdiction and procedure and consulted on it between 15 July 2013 and 6 September 2013. As part of the ERRA13 reforms, section 96 of the Enterprise Act 2002 (the Act) was amended to require that a 'merger notice' should contain prescribed information in a prescribed form. The CMA therefore consulted on a Merger Notice which would be implemented from 1 April 2014.[3]

3. A hallmark of the CMA's approach to merger control is to ensure that notifying parties are given sufficient information and guidance on the information requested in the Merger Notice (and throughout any investigation). The Merger Notice itself therefore contains guidance notes to support parties in considering the information to submit. In addition, to ensure that information can be provided in an efficient and proportionate manner, the Merger Notice introduced certain flexibility mechanisms, for example, provided that they give

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[1] The template Merger Notice and IEO are available on the CMA's website.
[2] See the Enterprise and Regulatory Reform Bill Policy Paper and CMA priorities and draft secondary legislation.
[3] See Consultation on Mergers Guidance. Many respondents to that consultation welcomed the decision to allow flexibility in the form in which a submission was provided (ie allowing parties to use the Merger Notice simply as a 'cross referencing' document to a standalone submission). However, significant concerns were raised as to the extent to which the Merger Notice pursued its stated objective of providing sufficient flexibility to allow the precise volume/nature of information to be tailored and proportionate to the case at hand. Stakeholders were also concerned that the new regime would lead to a lengthy pre-notification period (similar to that of the European Commission).

reasons for their view, parties can state that they consider certain information requested in the Merger Notice to be unnecessary for the assessment of a given case.

4. Against this general background, the purpose of this review was to assess how the Merger Notice has been used in practice and its effectiveness. The CMA focused on the following specific areas:

   (a) its scope, content and whether it is being used effectively, in particular regarding mergers involving small and medium enterprises and small transactions;

   (b) its impact on timing including the length of pre-notification and investigation time periods; and

   (c) the costs/burden on the CMA and the parties taking account of the need for the CMA to take reasoned and evidence-based decisions.

5. Based on the analysis of these factors, we assessed what concrete follow-up actions could be taken to streamline the use of the Merger Notice and enhance its effectiveness.

Initial Enforcement Orders

6. The ERRA13 introduced a series of new powers which strengthened the CMA's ability to remedy any competition concerns which may arise as a result of a merger. These are termed 'Initial Enforcement Orders' and this refers to orders which may be made by the CMA during its phase 1 assessment of a merger under section 72 of the Act, including prior to its formal commencement of its phase 1 investigation, in order to prevent action which may prejudice any reference to phase 2 or impede any remedial action taken or required by the CMA. The ERRA13 also abolished the power to accept initial undertakings. The purpose of an IEO is to prevent the further integration of the businesses of the parties. The CMA was also granted the power to impose orders to unwind pre-emptive action, but this has not yet been used. Merger parties often ask for (and the CMA grants, if appropriate) derogations to allow actions which otherwise would be in breach of the IEO.

7. Since March 2015, the CMA has adopted the practice of revoking IEOs as soon as it becomes clear, following investigation, that competition concerns

are very unlikely to arise. This is often significantly earlier than the substantive decision is announced.[4]

8. The review of the CMA's use of IEOs focused on:

   (a) the proportion of cases in which IEOs have been used;

   (b) the use of derogations including the type of derogations requested, the handling of requests and consistency of assessment;

   (c) the timing of the release of IEOs; and

   (d) the impact the use of IEOs has on the timing of the overall merger review process.

9. Based on the analysis of these factors, we assessed what aspects of the CMA's use of IEOs might require improvement and what concrete follow-up actions could be taken in that regard.

Methodology

10. In our review, we have:

   (a) conducted an in-depth review of a representative sample of cases[5] where we assessed the number of information requests in pre-notification, type of information requested and turnaround time;

   (b) considered our internal approach on the use of the Merger Notice and IEOs;

   (c) obtained views from over 20 law firms that regularly act for companies seeking merger control clearance and engage with the CMA in merger investigations and/or were involved in the notification of the sample of cases mentioned above, of which 18 provided their feedback to the CMA on the use of the Merger Notice and IEOs;

   (d) analysed data collected on IEOs issued by the CMA; and

   (e) undertaken an in-depth analysis of the IEOs issued and derogations imposed in a representative sample of cases.[6]

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[4] This generally takes place when the CMA determines, around the time of the state of play call with the merger parties, that a merger case will not go to a 'case review meeting' (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, paragraph 7.34).
[5] Representing around 20% of the total cases reviewed by the CMA until December 2015.
[6] Representing around 30% of the cases in which IEOs were imposed by the CMA until December 2015.

Merger Notice – Key findings

11. The Merger Notice was found to be broadly fit for purpose and functioning well. However, having regard to the internal and external feedback and our analysis of data, we consider that aspects of the Merger Notice and its use and the pre-notification process (pre-notification) could be further improved. In general our findings were that:

    (a) Pre-notification can be more streamlined and time-efficient.[7]

    (b) On average, for half of the pre-notification period the case rests with the CMA.

    (c) The CMA rarely stops the clock once a case has commenced its 40 working day period.[8]

    (d) The length of time spent investigating a merger on the statutory clock has decreased as a result of the introduction of the Merger Notice (compared with the Office of Fair Trading (OFT) phase 1 merger investigations)[9] and as a result of the new key performance indicators introduced by the CMA in its 2014/15 Annual Plan.

    (e) Pre-notification tends to be longer in cases involving: (i) completed mergers; (ii) cases involving multiple products and/or geographic markets; (iii) industries that have not been previously analysed by the CMA (or the predecessor organisations); or (iv) assessment of an alternative counterfactual.

    (f) No significant link could be found between the length of pre-notification and the size of the parties involved and the value of the transactions.

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[7] Taken from date of receipt of first draft Merger Notice or response to a CMA's request for information in non-notified mergers, the average length of pre-notification is 33 days across all cases since April 2015 until December 2015. This includes, for example, cases in which the first draft Merger Notice or response were of extremely poor quality and required multiple iterations. Taken from the date of submission of a materially complete draft Merger Notice, the average length of pre-notification is 11 days. The current target, which is calculated on this basis, is to conclude pre-notification in 20 working days (four weeks).

[8] The CMA has never stopped the 40 working days statutory clock with regard to mergers notified to the CMA using the Merger Notice. The CMA has stopped the 45 working days statutory clock in three cases that were referrals back from the European Commission under Art 4(4) European Union Merger Regulation. These are exceptional cases because the statutory review period commences automatically and immediately on referral back irrespective of whether the parties have made a satisfactory submission to the CMA.

[9] We note that there are significant differences between the two statutory frameworks (the OFT's ability to stop the clock in phase 1 and the reduced ability to do so in the CMA) and that any comparison between the length of the investigation at the CMA and at the OFT should be read with caution.

(g) In most cases the CMA sent more than one follow-up request for information in pre-notification.[10]

(h) The three categories of information most often the subject of follow-up information requests during pre-notification are: internal documents, data on shares of supply, and contact details of competitors and customers.

(i) Law firms generally consider that the Merger Notice is clear and that the structure is reasonable although the responses to some questions may overlap and some flexibility is required. Most law firms appear to use the template rather than using a bespoke version.

(j) The opportunity to request a waiver regarding information requested in the Merger Notice has been underutilised. The CMA's flexible approach to waiving questions in the Merger Notice which are not relevant to the specific case does not appear to be working optimally due, in part, to a lack of external understanding.

(k) The majority of the responding law firms considered that the Merger Notice is not being used proportionately in view of the potential competition concerns or the size of the deals and markets involved. Some law firms consider that case teams seek too much information up front to avoid stopping the clock later.

(l) Based on the cases reviewed by the CMA, the information collected at the outset of cases is generally used in the final decision and/or is relevant to inform the final decision.

(m) Law firms also commented that case teams request information for the assessment of theories of harm which they consider should have been ruled out early in pre-notification. However, our analysis showed that the theories of harm analysed at the outset are only very rarely not included in the final decision. We consider that this would not be the case if the decision maker thought that those theories of harm were without merit. The CMA has introduced more senior support to case teams at an early stage of the investigation to help with scoping and tailoring pre-notification. These mechanisms include having a preliminary assessment internal meeting in pre-notification, attended by the assistant director and, in some cases, by the director on the case. The level of senior involvement required is defined on a case-by-case basis.

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[10] In more than half of the cases there were more than two requests for information in pre-notification and, on average, a request for further information had around 13 questions.

12. Some law firms with more recent experience have noticed that the CMA has become more targeted in its approach to information requests and attribute this to the involvement of more senior input in pre-notification. In summary, our analysis shows that pre-notification is getting better at focusing the investigation on the theories of harm relevant to the case. However, the length of pre-notification can be reduced and, based on the external feedback, the CMA is still perceived as being over-inclusive in its information requests in pre-notification. This indicates that the CMA should look for opportunities to be more targeted and implement more streamlined procedures in pre-notification.

Merger Notice – Recommendations

13. Our analysis yielded a range of practical suggestions for incremental changes to the use of the Merger Notice and pre-notification processes. These actions can further improve the CMA's efficiency in gathering evidence during pre-notification and can consolidate practices within the phase 1 mergers unit that would be conducive to a more flexible and proportionate approach to pre-notification.

14. The CMA board met to discuss the recommendations and has approved them for implementation in the next financial year. These recommendations consist of the following:

Recommendation 1: Clarify the Merger Notice guidance notes and some minor amendments to the Merger Notice

15. We found that some follow up requests for further information in pre-notification result from a lack of clarity on the scope of some sections of the Merger Notice and of its flexibility.

16. We will take the following actions to improve the clarity and flexibility of the Merger Notice:

    (a) amend the wording of certain parts of the Merger Notice to improve clarity. Specifically, we consider that an excel template in which parties can provide contact details and a clearer definition of 'internal documents' would lessen the need for further information requests in relation to these areas; and

    (b) undertake a review of the Merger Notice's guidance notes to provide further clarity on when the information requested is essential. In particular, the CMA would seek to clarify the CMA's flexible approach waiving questions in the Merger Notice.

17. The CMA will launch a public consultation on the proposed amendments to the Merger Notice.

Recommendation 2 – Incremental changes to the pre-notification process for a more effective use of the Merger Notice

18. The CMA's review found that from an internal and external perspective there were clear benefits to pre-notification including: (i) to educate the case team where markets are complex and/or unfamiliar; (ii) to understand the merger, including its rationale and efficiencies, early on; and (iii) to clarify the information and evidence the CMA will require for the purposes of the Merger Notice in the case at hand, so as to be able to formally start its investigation on the 40 working day statutory timetable and/or will request early in the review process.

19. However, our review indicates that there is some scope to increase the focus of pre-notification on the theories of harm that are most likely to require further investigation. We also found that pre-notification tends to be longer in cases involving complex markets or industries that are new to the CMA and in cases that the CMA calls in without a proactive notification by the parties.

20. We aim to reduce the pre-notification period or to make it more useful, and improve the effectiveness of the use of the Merger Notice by taking the following actions:

    (a) When appropriate in complex mergers or in mergers involving markets not previously assessed by the CMA, request early engagement with the parties' management and/or business personnel prior to, or immediately after, the submission of the first draft Merger Notice to better understand the industry and their businesses.

    (b) As suggested by some law firms, engage with third parties in pre-notification – subject to the consent of the parties and when appropriate to understand third party views on the markets and the merger – in order to better scope the theories of harm that require further investigation. This can, in some instances, lengthen pre-notification so it is important to use this type of approach flexibly and in consultation with the parties so there is a mutual understanding as to the impact on pre-notification timescales.

    (c) Engage more proactively with the parties immediately after sending the Enquiry Letter under section 109 of the Act in Mergers Intelligence

cases.[11] This would involve explaining the reasons for the CMA investigation, the process and procedure and answering any questions that the parties may have.

(d) Continue to proactively engage with small and medium-sized enterprises that are seeking merger control clearance in pre-notification.

(e) Be open to early discussions with the parties in pre-notification in relation to the 'fast-track' procedure where appropriate.[12]

21. These incremental changes are part of the CMA's continuous review of internal procedures and engagement with stakeholders in view of a more effective merger review process.

Initial Enforcement Orders – Key findings

22. Our review of the CMA's use of IEOs has found that:

(a) IEOs are usually imposed within two to three working days after the CMA has received notification that a merger has completed or has received the necessary details to issue an IEO.

(b) The time that the case team needs to assess a derogation request varies significantly, partly due to the varying complexity of derogation requests, but there is scope for the assessment of derogations by the CMA to be more efficient.

(c) Internal and external feedback indicates that dealing with successive derogation requests is time consuming and may impact negatively on the length of the pre-notification period, as both the parties' and the case team's resources are focused on the derogations process instead of progressing the substantive aspects of pre-notification.

(d) All derogations are published (redacting commercially sensitive information) which ensures that the CMA's practice is transparent.

(e) While IEOs are imposed in most completed cases, reflecting the government's aims when it introduced the ERRA13, this is not automatic and there have been some limited exceptions (with either no IEO being imposed as in Atos/Countrywide; or a reduced, tailored IEO).

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[11] See *Mergers: Guidance on the CMA's jurisdiction and procedure*, paragraphs 6.15–6.19.
[12] Idem, paragraphs 6.61–65.

(f) The CMA's approach to derogations is broadly consistent, with some variations justified by the particular circumstances of each case.

(g) The feedback of the majority of law firms was that, in general, the CMA's use of its powers to impose IEOs is appropriate. In particular, law firms were positive about our change in practice (from March 2015) whereby IEOs are removed as soon as it becomes clear that competition concerns are very unlikely to arise (see paragraph 7 above).

(h) However, some law firms consider that the CMA should be more flexible in the imposition of IEOs and should not automatically impose IEOs in all completed mergers. They consider that IEOs are very burdensome on businesses and may make it difficult for them to continue to operate the target business as a viable business.

(i) Some law firms acknowledged the CMA's speed and flexibility in granting derogations, whilst noting that some standard derogations could be incorporated in the IEO up front.

(j) Some law firms identified some uncertainty on which actions require a derogation to be compliant with the IEO and on the type of derogations that the CMA is likely to grant. This uncertainty is unhelpful for the parties and may cause delay in the CMA's assessment of derogations.

23. Overall, our findings indicate that the CMA is using its powers to impose IEOs appropriately to prevent pre-emptive actions which could make implementing remedies more costly and difficult. However, the internal and external perception is that the CMA could, on occasion, be more efficient and more flexible in granting derogations. Some law firms also called for additional guidance on the CMA's approach to derogations and considered that the CMA should be more flexible in its practice of imposing IEOs in (almost) all completed mergers to avoid IEOs being imposed in cases where they think that would be disproportionate.

Initial Enforcement Orders – Recommendations

24. The review team recommended the following to further enhance and improve the CMA's use of IEOs.

25. The review team reported to the CMA board and it has approved the recommendations, most of which will be implemented in the next financial year. These recommendations are as follows.

Recommendation 1 – Provide additional guidance on the CMA's approach to derogations from IEOs

26. We found that there is lack of clarity on the parties' side regarding the actions requiring a derogation to be compliant with the IEO (eg a derogation is not required to share financial information for the purpose of regulatory reporting) and on the derogations that the CMA is likely to grant.

27. The CMA therefore will prepare and publish a guidance note, supplementing its existing guidance,[13] on the CMA's approach to derogations, based on the experience of the CMA so far. The objective of this action is to ensure a better understanding of the CMA's approach to derogations.

28. The CMA will launch a public consultation on the proposed guidance note.

Recommendation 2 – Introduce incremental changes to the process of assessing and granting derogations

29. We found that there is scope to reduce the response time to derogation requests (which may also lead to a shorter pre-notification period in some cases). We therefore will implement the following incremental changes:

    (a) Take further internal measures to standardise the process for granting derogations and, to the extent appropriate, their content.

    (b) Encourage the merger parties to adopt the good practice of requesting the derogations they need shortly after the imposition of the IEO, reminding them that staggered requests distract from the investigation and could mean a more protracted investigation.

    (c) Consider whether the IEO template can be adapted to incorporate more exceptions.

30. The objective of these actions is to ensure a more efficient operation of the derogations process, including facilitating a quicker response to relatively standard derogation requests.

Recommendation 3 – Consider whether it is possible for the CMA to be more targeted in the imposition of IEOs

31. The CMA's current approach to issuing IEOs is based on the presumption that IEOs should be imposed in all completed mergers, apart from exceptional

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[13] *Mergers: Guidance on the CMA's jurisdiction and procedure*, Annex C.

cases, to mitigate the risk of the parties integrating their businesses in cases where remedial decision may be necessary.

32. Some law firms consider that the imposition of IEOs may not be justified in all completed mergers and that there is scope to tailor the IEO to exclude some actions from the IEO up front.

33. Therefore, whilst maintaining the presumption that IEOs should normally be imposed in all completed mergers, in the medium term (next two years), we will consider whether there might be an objective set of circumstances in which the risk of not imposing IEOs is minimal and imposing IEOs may be considered disproportionate.

34. With this assessment, we want to ensure that the use of the CMA's power to impose IEOs is proportionate. However, we consider that it is premature to implement these changes in the short term as the CMA still need to consolidate its still relatively limited experience in using this power under the new legal framework.