

# Mergers: Exception to the duty to refer in markets of insufficient importance

Consultation document

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# 1. About the consultation

## Introduction

- 1.1 The Competition and Markets Authority (CMA) has responsibility for review of mergers under the Enterprise Act 2002 (the Act). Under the Act, the CMA has a duty to refer a merger for a second phase (phase 2) investigation where it believes there to be a realistic prospect that the merger will result in a substantial lessening of competition (SLC). At sections 22(2) and 33(2), the Act provides a number of discretionary exceptions to this duty to refer.
- 1.2 The CMA is consulting on amendments to its guidance on how the CMA applies the exception to its duty to refer in markets of insufficient importance.
- 1.3 Specifically, the CMA is proposing to update this guidance to:
  - (a) increase the market size threshold over which the CMA considers that the market(s) concerned will generally be of sufficient importance to justify a reference from £10 million to £15 million;
  - (b) increase the market size threshold below which the CMA will generally not consider a reference justified from £3 million to £5 million.

## Scope of the consultation

- 1.4 The scope of this consultation covers the indicative market size thresholds set out in the guidance on the application of the markets of insufficient importance exception set out in Chapter 2 of the CMA's guidance on the exception to its duty to refer and undertakings in lieu of reference, [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance \(OFT1122\)](#), issued in December 2010 and adopted by the CMA board in April 2014 (2010 Guidance).
- 1.5 Subject to consultation responses, the updated guidance will be implemented by amending the references to the relevant market size in Chapter 2 of the 2010 Guidance. The other chapters of the 2010 Guidance will remain substantively unchanged.

## Background

### Context

- 1.6 The CMA is a non-ministerial department formed on 1 April 2014. It is a primary competition and consumer authority which took over a number of

functions formerly performed by the Office of Fair Trading (OFT) and those of the Competition Commission (CC). The CMA works to promote competition for the benefit of consumers, both within and outside the UK, to make markets work well for consumers, businesses and the economy.

- 1.7 Mergers can bring benefits to the economy and help businesses and markets grow. Many are pro-competitive or have a benign effect on competition. However, some can harm competition and result in, for example, higher prices, reduced quality or choice for consumers, or reduced innovation. The aim of merger review is to ensure that mergers do not substantially lessen competition and lead to worse outcomes for consumers.
- 1.8 As noted above, the CMA has responsibility for review of mergers under the Act and has a legal duty to refer a merger to phase 2 investigation where there is a realistic prospect of an SLC. At sections 22(2) and 33(2), the Act provides a number of discretionary exceptions to this duty to refer. This consultation concerns one of these – the markets of insufficient importance exception (referred to as the ‘de minimis exception’).
- 1.9 The exception was introduced in order to avoid references where the costs involved would be disproportionate to the size of the markets concerned.<sup>1</sup> However, the Act did not specify the criteria the CMA should consider in exercising this discretion, and leaves that to the judgment and expertise of the CMA.<sup>2</sup> As such, the CMA’s predecessor, the OFT, issued guidance on how it would exercise this discretion.
- 1.10 The guidance on the exception has been revised a number of times since its introduction in 2003 via the Act, in 2003, 2007 and 2010 in the 2010 Guidance.
- 1.11 The OFT’s 2003 Guidance indicated that the exception was restricted to those few cases where the affected market size in the UK was around £400,000 (the expected costs of a CC reference) or less.<sup>3</sup> The 2003 Guidance was not applied to any cases in the time it was in place.

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<sup>1</sup> As noted in the [Explanatory Notes](#) to those parts of the Enterprise Bill which eventually became sections 22(2) and 33(2) of the Enterprise Act, which state: ‘The discretion for the [CMA] to decide not to refer a merger because the market is of insufficient importance is designed primarily to avoid references being made where the costs involved would be disproportionate to the size of the markets concerned.’

<sup>2</sup> See in particular the comments made by, Melanie Johnson, the then Parliamentary Under-Secretary for Trade and Industry, to the House of Commons Standing Committee in relation to a proposed amendment that would have required a legislative definition of the term ‘sufficient importance’ for the purposes of the exception, who noted: ‘The Government believe that judgments of that type are best made on a case-by-case basis by the experts in the competition authorities.’

<sup>3</sup> See summary in [Consultation Document for November 2007 Guidance, OFT 933con](#).

- 1.12 In 2007, the OFT adopted new guidance which sought to ensure the exception would be applied to a greater number of cases than the 2003 Guidance in a manner that was consistent with its Parliamentary and policy objectives. The 2007 Guidance did this by introducing two key elements:
- (a) The principle that the exception should be applied with consideration to a cost/benefit analysis, whereby the costs of a reference should be balanced against the benefit of the consumer harm that may be avoided as a result of remedies imposed following a phase 2 investigation.
  - (b) An indicative market size of £10 million above which the exception was generally unlikely to apply but below which it might. Consistent with the cost/benefit approach, the £10 million figure was chosen following a consideration of what market size might imply sufficient customer harm to justify a reference in an illustrative scenario based on a number of variables, including: (i) the price rise that might be avoided; (ii) the duration for which a price rise might be avoided; (iii) the cost of a reference; (iv) the likelihood of a reference; and (v) the expected cost to benefit ratio.<sup>4</sup>
- 1.13 In 2010, the OFT further updated its guidance on when it will exercise its discretion under the 'de minimis' exception, which the CMA has adopted.
- 1.14 The 2010 Guidance maintained the cost/benefit approach set out in the 2007 Guidance and the 'upper bound' £10 million market size figure and estimated that the average public cost of a reference against which potential consumer harm ought to be weighed was still around £400,000. However, in addition to the existing upper bound market size, it introduced a 'lower bound' £3 million market size below which the exception would generally apply. The 2010 Guidance also clarified that the 'de minimis' exception would not be available, even when the market size was below £3 million, where clear-cut undertakings in lieu of a phase 2 reference may be available.
- 1.15 The 2010 Guidance can be summarised as follows:
- (a) The CMA considers that the market(s) concerned will generally be of sufficient importance to justify a reference (such that the exception will not be applied) where its/their annual value in the UK, in aggregate, is more than £10 million. By contrast, where the annual value in the UK of the

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<sup>4</sup> The OFT stressed that this was an illustrative example and noted the possible significance of other variables, although it did not expressly include these in its calculation. In particular, in paragraphs 4.13 and 4.14 of the Consultation Document for the 2007 Guidance, the OFT explained that: (i) reference costs could vary; (ii) third party costs might double the implied size; (iii) deterrence factors (ie the impact of finding and preventing problematic mergers has on stopping further potentially problematic mergers from happening) could significantly reduce it.

market(s) concerned is, in aggregate, less than £3 million, the CMA will generally not consider a reference justified provided that there is in principle not a clear-cut undertaking in lieu of reference available.

(b) Where the annual value in the UK, in aggregate, of the market(s) concerned is between £3 million and £10 million, the CMA will consider whether the expected customer harm resulting from the merger is materially greater than the average public cost of a reference to phase 2 (currently around £400,000). The CMA will base its assessment of expected customer harm on: the size of the market concerned; its view of the likelihood that an SLC will occur; its assessment of the magnitude of any competition that would be lost; and its expectation of the duration of that substantial lessening of competition.

(c) The CMA will also take account of the wider implications of its decisions in this area, and will be less likely to exercise its discretion, and therefore more likely to refer, where the merger is potentially replicable across a number of similar markets in a particular sector.<sup>5</sup>

1.16 Since the introduction of the first guidance on the exception, the CMA and its predecessors have gained extensive experience of applying the exception. The exception has been applied in 26 of the 33 cases where it has been considered since the introduction of the 2010 Guidance.<sup>6</sup> The CMA therefore believes that it has sufficient experience of using the 2010 Guidance and the existing indicative market size thresholds to understand the risks in terms of potential consumer harm of changing these.

1.17 The 2016/17 Annual Plan set out a commitment that the CMA would consider and consult on revised guidance, where there was a case for change.<sup>7</sup>

### ***Changes proposed***

1.18 The CMA is proposing to amend the 2010 Guidance to raise the thresholds at which the 2010 Guidance states that the 'de minimis' exception will generally not apply, and when it would be more likely to apply. Specifically, the CMA is proposing to increase:

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<sup>5</sup> [2010 Guidance](#), paragraphs 2.2–2.4.

<sup>6</sup> As at December 2016.

<sup>7</sup> [CMA Annual Plan 2016/17](#), paragraph 3.11.

- (a) the 'upper bound' threshold, ie the threshold over which the CMA considers that the market(s) concerned will generally be of sufficient importance to justify a reference from £10 million to £15 million; and
- (b) the 'lower bound' threshold, ie the threshold below which the CMA will generally not consider a reference justified from £3 million to £5 million.

- 1.19 The CMA would not make any other substantive changes to the 'de minimis' guidance and therefore would retain the cost/benefit approach underpinning the choice of these thresholds and the application of the 'de minimis' exception more generally.
- 1.20 The CMA's provisional view is based on an internal review, which considered: (i) the continuing relevance of the cost/benefit approach; (ii) the case for increasing the thresholds generally; and (iii) the use of the 2010 Guidance in past cases for the purposes of determining the specific increase which may be appropriate, including the costs and benefits of any change.
- 1.21 The CMA believes that these proposals are appropriate as they would lead to the following benefits:
- (a) A reduction in the costs faced by the CMA in investigating phase 2 and phase 1<sup>8</sup> mergers and an opportunity to use this resource in the delivery of discretionary functions such as market investigations, competition investigations or consumer enforcement actions.
  - (b) A reduction in the burden of merger control on businesses due to:
    - (i) the wider scope to self-assess, particularly at the lower threshold, and avoid the merger notification altogether as a greater number of business can take comfort that the exception could apply to them and may therefore not be investigated by the CMA on its own-initiative;<sup>9</sup> and
    - (ii) the wider scope for the 'de minimis' exception to apply and avoid more intensive review.
- 1.22 In addition to the benefits noted above, the CMA further believes these proposals are appropriate as:

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<sup>8</sup> For example, where the exception is applied when considering whether to send an enquiry letter to trigger an own-initiative investigation or at an early stage of phase 1.

<sup>9</sup> Please see the [Guidance on the CMA's Mergers Intelligence Functions \(CMA56\)](#), 17 June 2016 and paragraphs 2.46 to 2.48 of the 2010 Guidance.



- (a) the indicative thresholds, based on a review of past case practice, are consistent with where: (i) the CMA could find that the customer harm that market size implies will not generally justify a reference; or (ii) that the customer harm that market size implies could generally justify a reference; and
- (b) by maintaining the approach to assessment but changing the relevant indicative thresholds, the CMA will continue to exercise its discretion in a manner consistent with statutory intent by using its judgment and expertise to make a case-by-case assessment, centred on maximising customer benefit across any market, including innovative/nascent markets.

1.23 The CMA would, in any case, remain committed to reviewing the application of the 'de minimis' exception regularly with a view to changing or raising thresholds further in the future, particularly as its wider organisational functions may evolve and change.

## **Consultation process**

1.24 We are publishing this consultation on the CMA webpages and drawing it to the attention of a range of stakeholders to invite comments. We would welcome your comments on the content of the draft guidance and, in particular, to the questions raised in Chapter 2 of this document. We want to ensure that the guidance is clear, comprehensive and useful for its intended users.

### ***How to respond***

1.25 We are seeking the views of interested parties. Please respond to as many of the questions as you can and, where relevant, please support your answers with any evidence or examples you may have. We encourage you to respond to the consultation in writing using the contact details provided in paragraph 1.28 below.

1.26 When responding to this consultation please state whether you are responding as an individual or are representing the views of a group or organisation. If the latter, please make clear who you are representing and their role or interest.

1.27 In pursuance of its policy of openness and transparency, we will publish non-confidential versions of responses on our webpages. If your response contains any information that you regard as sensitive and that you would not wish to be published, it would be helpful if you could also provide a non-

confidential version for publication on our webpages which omits that material with an accompanying explanation as to why you regard it sensitive.

### ***Duration***

- 1.28 The consultation will run for three weeks, from Monday 23 January 2017 to Monday 13 February 2017. Responses should be submitted by post or email, by no later than **5pm on Monday 13 February 2017**, and should be sent to:

Alba Ziso  
Competition and Markets Authority  
Victoria House  
37 Southampton Row  
London WC1B 4AD

Email: [alba.ziso@cma.gsi.gov.uk](mailto:alba.ziso@cma.gsi.gov.uk)

### ***Compliance with government consultation principles***

- 1.29 In consulting, the CMA has taken into account the government consultation principles, which set out the principles that government departments and other public bodies should adopt when consulting with stakeholders. Full details can be found on [GOV.UK](http://GOV.UK).

### ***Data use statement for responses***

- 1.30 Personal data received in the course of this consultation will be processed in accordance with the Data Protection Act 1998. Our use of all information received (including personal data) is subject to Part 9 of the Enterprise Act 2002. We may wish to refer to comments received in response to this consultation in future publications. In deciding whether to do so, we will have regard to the need for excluding from publication, as far as that is practicable, any information relating to the private affairs of an individual or any commercial information relating to a business which, if published, might, in our opinion, significantly harm the individual's interests, or, as the case may be, the legitimate business interests of that business. If you consider that your response contains such information, that information should be marked 'confidential information' and an explanation given as to why you consider it is confidential.
- 1.31 Please note that information provided in response to this consultation, including personal information, may be the subject of requests from the public for information under the Freedom of Information Act 2000. In considering such requests for information we will take full account of any reasons provided

by respondents in support of confidentiality, the Data Protection Act 1998 and our obligations under Part 9 of the Enterprise Act 2002.

- 1.32 If you are replying by email, these provisions override any standard confidentiality disclaimer that is generated by your organisation's IT system.

***After the consultation***

- 1.33 After the consultation, we will publish a final version of the guidance and a summary of the responses received that fall within the scope of the consultation. As noted above, we propose to publish non-confidential versions of the responses received. These documents will be available on our webpages and respondents will be notified when they are available.

## **2. Questions for consideration**

Q1. Do you agree with the proposed changes to the thresholds?

Q2. Do you agree with the potential benefits of these proposals?

Q3. Do you have any other comments about the proposed changes?