24 February 2017

CMA CONSULTATION ON MEGERS: EXCEPTION TO THE DUTY TO REFER IN MARKETS OF INSUFFICIENT IMPORTANCE - 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 exception to the duty to refer in markets of insufficient importance.

1.2 As a preliminary observation, we welcome the propose increase in thresholds, and the greater degree of pragmatism that the CMA has shown in its more recent decisional practice in relation to markets of insufficient importance. However, we consider that the relatively modest increase of the 'indicative' market size thresholds would be insufficient to address the wider challenges the UK merger control regime faces insofar as mergers affecting markets of 'insuffient importance' are concerned. We therefore encourage the CMA to: (i) grant itself more flexibility in widening the scope of cases where a market is found to be of 'insufficient' importance within the existing legislative framework; and (ii) in exchange, provide merging parties with a greater degree of legal certainty in response to informal notifications of mergers falling into this category. These suggestions are set out in more detail below.

1.3 In addition, while outside the scope of the current consultation, we also suggest below some key legislative reforms that we consider will be necessary to address the challenges the UK merger control will be facing post-Brexit, in partiulcar the significant increase in the number of cases the CMA anticipates it will review. These are the introduction of a statutory safe harbour that would exclude transactions involving targets with low levels of UK turnover from the CMA's merger control jurisdiction, and creation of greater flexibility in Phase 1 decision-making through the the replacement of the statutory duty to refer with a discretionary power to refer.

2. THE CMA'S QUESTIONS

2.1 We address each of the CMA's questions set out in its consultation document below.

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

2.2 The consulation document proposes a relatively modest increase of the marke size thresholds which supposedly indicate whether a market is of 'insufficient importance' for the purposes of this exception to the duty to refer.

2.3 First, we note that the consultation document does not refer to specific cases evidencing any limitations or issues the current thresholds may have given rise to in practice. As such, it does not set out explicitly the case for change. In our view, it would have been preferable for the consulation document to provide at least a few examples of cases where the CMA considered that the thresholds under its existing guidance were inadequate in that they, for instance, prevented it from exercising it discretion to apply the 'de minimis' exception to the duty to refer. However, we recognise that referencing specific cases may have been undesirable from the CMA's perspective, in particular

insofar as such cases (likely to have been cleared in the meantime) would have resulted in greater costs than necessary for both the parties and the CMA given the prolonged administrative process they would have been subjected to.

2.4 In any event, having performed a desktop analysis of the more recent 'de minimis' decisions by the OFT and the CMA, we have observed two main developments regarding the authority's decisional practice: (i) an increase in the number of cases where the CMA applied the 'de minimis' exception at an earlier stage of the proceedings, in particular to obviate the need for an Issues Meeting and (ii) in increase in the number of cases where the CMA applied the 'de minimis' exception in circumstances where either the size of the market or the segment of the market most affected by the SLC finding was close to the current 'upper bound' of £10m. The latter development is perhaps best exemplified by the CMA's decision in WGSN/Stylesight where the relevant segment of the market in question (and certainly the wider market) appear to have come close to (or possibly even exceeded) the current £10m threshold above which the CMA is generally unlikely to apply the 'de minimis' exception. We welcome both of these developments, in particular insofar as they illustrate a greater degree of pragmatism the authorities have shown in their more recent decisional practice.

2.5 However, we consider that a mere – and relatively modest – increase of the 'indicative' market size thresholds does not address the wider challenges the UK merger control regime faces insofar as mergers affecting markets of 'insuffient importance' are concerned. We would therefore encourage the CMA to: (i) grant itself more flexibility in widening the scope of cases where a market is found to be of 'insufficient' importance within the existing legislative framework; and (ii) in exchange, provide merging parties with a greater degree of legal certainty in response to informal notifications of mergers falling into this category. These suggestions are set out in more detail below.

2.6 First, the proposals fall short of comprehensively addressing the CMA's underlying difficulties in applying the 'de minimis' exception to cases that do not warrant a Phase 2 investigation. These shortcomings result from an overly narrow focus of the proposed changes on the 'size of the market'. As the consultation document sets out, the CMA will also base its assessment of whether a market is of 'insufficient importance' on other aspects relating to 'expected customer harm', including 'its view of the likelihood of an SLC, its assessment of the magnitude of any competition that would be lost and its expectation of the duration' of a substantial lessening of competition.

2.7 Any revision of the CMA's 'de minimis' policy should provide the CMA with more flexibility to allow for greater use of this exception in appropriate cases. This is implicit in the proposed changes which are clearly designed to widen the scope of this exception. However, the sole focus on the size of the market suggests that the CMA may not depart from applying its internal 'graphic equaliser' methodology to determine whether it should exercise its discretion to apply the 'de minimis' exception. It would merely use slightly increased market sizes as a starting point for such calculations. Even if the CMA no longer applies a 'graphic equaliser' methodology, its internal considerations would still largely be determined by the size of the market with other relevant factors playing only a minor role.

2.8 The consultation document cites 'the wider scope to self-assess' as one the benefits of the proposed changes. However, self-assessment is not necessarily facilitated by the current proposals, in particular as they are confined to the changes relating to the size

of the market. As the CMA will be aware from its own (often complex) determiniation of whether the 'de minimis' market size thresholds are met, it can be very challenging and burdensome in practice to determine the size of the market. This is even more difficult for the parties than for the CMA as the merging parties are unable (for good reasons) to reach out to other market participants with a view to determining their competitors' turnover.

2.9 We consider that a revision of the 'de minimis' policy should allow the CMA to place more weight on other factors that may legitimately lead the CMA to conclude that the market at issue is of 'insufficient importance'. Such factors may be related to the size of the market, but not necessarily so. One such factor should, in our view, be the turnover generated by the target company in the UK. Specifically, where the turnover of the target in the UK does not exceed £10m, the CMA should generally not consider a reference justified.

2.10 A specific reference to the target's turnover not exceeding £10m would greatly facilitate self-assessment and therefore enhance legal certainty. It would also be consistent with the affected market (or segment of the market) being of insufficient importance: the target's turnover will often not be generated solely in the market that might be affected by a potential SLC finding. Even if it was, the target would have to have extremely high market shares for the size of the market in question to be materially larger than the CMA's currently proposed upper bound threshold of £15m.

2.11 The CMA's existing guidance already recognises that, when assessing whether a market is of "sufficient importance" to justify a reference, it is relevant to consider the likely or potential impact of the merger on the market in question. Taking into account the size of the target would be an extension of this principle, with the advantage that it is quantifiable and can therefore be implemented by way of a threshold that would increase legal certainty.

2.12 In exchange for greater flexibility in widening the scope for markets to be found of 'insufficient importance' by relying more heavily on other relevant factors (including the target's UK turnover), the CMA should provide merging parties with a greater degree of legal certainty in response to a notification setting out why the parties consider the 'de minimis' criteria to be met. The CMA should consider devising a **'targeted notification form'** which could be used more widely for unproblematic cases in the future, irrespective of whether they meet the 'de minimis' criteria. This would reduce some of the burden for parties who currently submit full Merger Notification Forms in less relevant cases and may be an increasingly urgent requirement for the CMA to focus its resources on the most important cases, in particular in light of the anticipated increase in cases post-Brexit.

2.13 Where parties submit such a 'targeted notification form' and the CMA decides not to open a formal investigation immediately, the CMA should go beyond its current practice (operated by its mergers intelligence committee) to merely 'contact the main parties and indicate that it has no further questions at this stage.' Instead, the CMA could declare, in response to a 'targeted notification form', that it is currently **not minded to investigate the merger**. Language to the effect would have the following advantages: (i) it provides a greater degree of legal certainty, (ii) it could potentially be used as a 'condition precedent' in transaction documents such as SPAs, and (iii) it nevertheless would not compromise the CMA's ablity to formally investigate the merger should

further evidence come to light (for instance as a result of third party submissions) that suggest the duty to refer and therefore to investigate may be triggered.

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

2.14 As indicated above, we do not consider that the current proposals result in a materially 'wider scope to self-assess'. Self-assessment would be assisted by relying more heavily (and explicitly) and criteria that are more easily verifyable for merging parties. We therefore consider that the CMA should place more emphasis on other factors which could lead to the conclusion that a market is of 'insufficient importance'. Specifically, the CMA should make explicit referenc to the target's UK turnover not exceeding £10m as one of the factors indicating that the CMA will likely exercise its discrection to apply the 'de minimis' exception.

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

2.15 We understand that these proposals are not designed to address the challenges the UK merger control will be facing post-Brexit, in partiulcar the significant increase in the number of cases the CMA anticipates it will review. As such, we understand that consultation responses should be confined to proposals that can be implemented within the existing legislative framework.

2.16 However, we belive that that the CMA should consider revising its 'de minimis' policy with possible regime challenges and potential changes in mind. In our view, unless it receives a very substantial increase in resources the CMA will have to focus on those cases that are most likely to give rise to potential consumer harm. As a result, mechanisms will need to be devised which reduce the burden for both the CMA and merging parties in smaller mergers (and) where the magnitude of harm is likely to be limited. One option consists of introducing 'safe harbours' for mergers where the target generates less than £20m in the UK. This would remedy a serious failing in the current regime for consideration of markets of insufficient importance, which is that the assessment comes only at the end of a Phase 1 review, such that the CMA (and the merging parties) will already have incurred often very substantial costs before the exception is considered. In other words, the exception to the duty to refer allows only for consideration of the taxpayer cost of a Phase 2 investigation, but does nothing to prevent the disproportionate use of taxpayers' resources, in Phase 1 investigations, to establish whether a merger risks giving rise to an SLC before assessing whether the de minimis exception may be engaged. A safe harbour threshold for target turnover – which we recognise would likely require legislative amendments – would address these deficiencies. In the meantime, the CMA should consider introducing tools, such as a 'targeted notification form' outlined above, which would allow it to reduce its workload prior to legislative changes being made.

2.17 Another legisltative reform that we consider would merit careful consideration is the introduction of a statutory discretion to refer mergers for Phase 2 investigation if the relevant SLC test is met, in place of the current statutory duty. In our experience, the duty to refer already results in excessively cautious decision-making in some cases, with some mergers being referred on the basis of highly speculative and theoretical concerns. We consider that the substantial increase in the number of UK merger control reviews, post-Brexit will necessitate more flexibility in Phase 1 decision-making, which could be achieved through a discretionary statutory power to refer.

Clifford Chance LLP
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