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

Summary of responses to the consultation

16 June 2017

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1. Introduction

Background and summary

1.1 The Competition and Markets Authority (CMA) is a non-ministerial department formed on 1 April 2014. It is the UK's primary competition and consumer authority and took over a number of functions previously performed by the Office of Fair Trading (OFT) and 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.

1.2 The 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). Sections 22(2) and 33(2) of the Act provide a number of discretionary exceptions to this duty to refer.

1.3 Following a consultation[1] and consideration of the responses received, on 16 June 2017 the CMA has updated its guidance on how it applies the exception to its duty to refer in markets of insufficient importance (referred to as the 'de minimis' exception).

1.4 Specifically, the CMA has updated this guidance to:

(a) increase the market size threshold above 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) increase the market size threshold below which the CMA will generally not consider a reference justified from £3 million to £5 million.

1.5 The updated guidance has been implemented by updating and replacing 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)[2] with Mergers: Exception to the duty to refer in markets of insufficient importance (CMA64).

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[1] Mergers: Exception to the duty to refer in markets of insufficient importance: Consultation document (23 January 2017).
[2] Originally issued in December 2010 and adopted by the CMA board in April 2014.

CMA64 reflects the increased thresholds for the de minimis exception. The other chapters of the OFT1122 remain substantively unchanged.

Purpose of this document

1.6 The consultation document that accompanied the draft guidance set out a series of specific questions on which respondents' views were sought (see Annex A). This document sets out a summary of responses and additional key issues raised as part of the consultation together with the CMA's views on those submissions. It is not intended to provide a comprehensive record of all views expressed by respondents: respondents' full responses are available on the consultation page.

1.7 This document should be read in conjunction with the consultation document, which contains further background and explanation on the 2010 Guidance.

2. Issues raised in the responses to the consultation

2.1 The CMA received 17 responses to the consultation from a range of stakeholders including private businesses, legal advisers and industry bodies. A full list of respondents can be found in Annex B.

2.2 Overall, the majority of respondents supported the changes as set out in the consultation, ie the specific increases to the thresholds recommended.

2.3 Further detail on the key themes covered by the responses and the CMA's views in relation to these issues are set out below.

Background to project and role of Brexit

Respondent views

2.4 Seven respondents commented on the significance of the proposed changes in the context of Brexit and the related potential for an increase in the number of mergers which may be reviewed by the CMA. Two of these respondents indicated that these changes were appropriate for the purposes of helping the CMA face any such future challenges. However, five respondents suggested that the CMA's proposals were not sufficient for the purposes of responding to the potential challenges that Brexit may pose. The latter set of responses propose that as a consequence of the potential for an increased number of mergers to review with limited additional resource, the CMA should take a new and broader approach to exercising its discretion in relation to markets of insufficient importance than envisaged by the consultation.

CMA's views

2.5 The consultation formed part of the CMA's ongoing review of its guidance,[3] with the objective of lessening the burden on businesses and the CMA generally. In this context, the proposed increases in the thresholds were not intended as a response to any potential future increases in the CMA's caseload, but rather as a reflection of the OFT and CMA's experience in applying the exception since the 2010 Guidance was issued.[4]

2.6 The CMA is mindful of the significant implications of Brexit and the role the exception could play in the future in addressing some of these implications. However, the CMA has decided to implement the revisions resulting from its

[3] CMA Annual Plan 2016/17, paragraph 3.11.
[4] Consultation document, paragraph 1.16.

review and consultation on this issue now so that the CMA, businesses and consumers begin to benefit from these changes immediately.

Respondent proposals for additional or alternative changes to guidance

Respondents' views

2.7 Seven respondents broadly welcomed the review and the proposal to widen the CMA's discretion in relation to the de minimis exception but considered that the CMA should widen its discretion further than proposed. Specific proposals in terms of how the CMA might widen its discretion further varied in scope but the key themes can be summarised as follows:

(a) Recommendations encouraging increased use of the guidance at earlier stages of phase 1.

(b) Recommendations focused on increasing and varying how the thresholds are applied. These included proposals to:

(i) consider merging party costs as part of the relevant costs of a phase 2 reference against which consumer harm and, therefore, necessary market size should be judged;

(ii) reconsider the public costs of a phase 2 reference on the basis that any increase in such costs may justify a further increase in the thresholds;

(iii) take account of the parties' turnover in determining whether the exception should apply; and

(iv) increase the market size threshold above which the exception will not generally apply more significantly.

(c) Recommendations to change the guidance with respect to circumstances which could prevent the application of the exception, ie where undertakings in lieu are in principle available.

(d) Proposals to introduce legislative changes which would set definitive safe harbours.

2.8 The CMA responds to these issues below.

The CMA's views

Earlier application of the exception at phase 1

2.9 In its consultation, the CMA explained that the changes to the guidance were provisionally considered appropriate as they would lead to the following benefits:

(a) A reduction in the overall costs faced by the CMA in investigating phase 2 and phase 1 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 the wider scope:

(i) to self-assess at phase 1, particularly at the lower threshold, and avoid the merger notification altogether due to a wider set of transactions falling within the exception; and

(ii) to avoid more intensive phase 2 review.

2.10 As such, earlier application of the exception both by merging parties and the CMA is central to the CMA's view that increasing the thresholds could give rise to benefits for businesses, consumers and the CMA. The CMA believes that this will be possible based on the current guidance, with the amended thresholds, for the following reasons:

(a) There is wider scope to self-assess at the lower threshold as application of the exception is not contingent on determining whether the magnitude of the SLC, duration of the harm etc could, in the context of the market size, nonetheless imply consumer harm which exceeds the costs of a reference, as is necessary for markets with aggregate turnover over £5 million but under £15 million.[5]

(b) The guidance contains detailed consideration of how the exception can be used to reduce the burdens of phase 1 investigations through its role in informing the CMA's view of whether to send an enquiry letter to trigger an own initiative investigation or at an early stage of phase 1.[6] The CMA has also issued separate guidance on its mergers intelligence function

[5] CMA64, paragraphs 13–15.
[6] See CMA64, paragraphs 47–49 and 52–54.

and how merging parties and third parties can engage with the CMA in this context.[7]

(c) CMA practice to date shows increasing use of the exception at earlier stages of the investigation. At the CMA, of the 14 cases where the exception was applied, eight did not progress as far as a case review meeting.[8] At the OFT, this was the case in only four of 12 cases where the exception was applied.

2.11 However, recognising the responses received, the CMA notes that it remains committed to considering the use of the exception at earlier stages of the merger control process where appropriate. In addition, the CMA will seek to provide further guidance and clarity on the application of the exception to markets under £5 million in its public decisions where relevant.

Inclusion of merging party costs

2.12 The CMA does not consider that there is a strong case for including costs to merging parties in order to justify further increases in the market size thresholds. As noted in previous consultations relating to changes to the exception,[9] merging parties have a choice to pursue potentially anti-competitive transactions and may structure transactions to reduce merger control risk. In that context, to include costs incurred by merging parties as a factor in widening the scope of an exception to the application of merger control, would risk significant unintended consequences.

Phase 2 costs

2.13 As part of its review the CMA conducted a detailed review of phase 2 costs. This did not indicate an increase in actual phase 2 costs to justify higher thresholds. Indeed, the costs of a phase 2 reference, taking account of staffing, non-staff expenditures and notional allocation to central overheads have remained below £400,000 on average. In fact, the evidence available to the CMA indicates that, due to efficiency measures, the costs of a phase 2 reference over the past two years at the CMA have been either similar to or lower than the costs of a phase 2 reference in the final years at the CC.

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[7] Please see the Guidance on the CMA's Mergers Intelligence Functions: CMA56 (17 June 2016).
[8] Data up to date as at April 2017. See Mergers: Jurisdiction and Procedure Guidance: CMA2 (January 2014), paragraphs 7.32–7.49 for an explanation of the phase 1 decision-making process and case review meetings.
[9] See the consultation document, paragraphs 1.6 & 1.17.

Relevance of merging parties' turnover

2.14 As appropriate, the merging parties' turnover may provide a helpful starting point for determining the appropriate market size for the purposes of self-assessment of whether the exception may apply. However, once the CMA has found a realistic prospect of an SLC, consumer harm may affect all customers in the market, not just customers of the merging parties, and therefore it is the market size, rather than the size of the parties, that is appropriate to determine that the market is insufficiently important to justify a reference. The parties' turnover alone will generally not provide enough information to make this judgment. As such, while the CMA appreciates that providing indicative thresholds on this basis may increase legal certainty, it would also increase the risk of consumer harm in markets of sufficient importance not being prevented and therefore would not be an appropriate measure for this purpose.

Increasing the thresholds further

2.15 The CMA reached the £5 million and £15 million market size proposals by evaluating the cost and benefits associated with higher thresholds in relation to phase 1 and phase 2 mergers in the last three years. The costs would be as a result of the exception being applied to potentially problematic cases which are no longer investigated; while the benefits were judged by reference to any cost savings as a result of fewer phase 2 cases or, in relation to the lower threshold, fewer phase 1 cases being notified or called in by the CMA.

2.16 The CMA's assessment indicated that the proposed revised thresholds were appropriate as a means of maximising benefits and minimising costs. In particular, based on decisional practice, the thresholds are consistent with where, at the lower level, the customer harm will not generally justify a reference; and, at the higher level, the customer harm will generally justify a reference.

2.17 The CMA considered raising the thresholds further but considered this to introduce an unacceptable risk in terms of preventing consumer harm. As noted in the consultation document, the CMA remains 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.[10]

[10] Consultation document, paragraph 1.23.

Availability of undertakings in lieu

2.18 As explained in its guidance,[11] the CMA's general policy is not to apply the exception where clear-cut undertakings in lieu of reference could be offered by the merging parties to resolve the competition concerns identified, for the following reasons:

(a) The aim of the exception is to avoid the cost of a reference where this is not proportionate to the harm identified. Undertakings in lieu of reference avoid the risk of customer harm identified by the CMA – yet at the same time avoid in full the costs of a reference.

(b) Even where the market(s) concerned is/are small in size, parties should remain incentivised to offer clear-cut undertakings in lieu to remedy concerns or to design their transactions to avoid anti-competitive effects (sometimes known as a 'fix it first' approach).

(c) The costs of a reference in an individual case[12] are outweighed by the long-run, aggregated benefit of remedial action in similar cases at the phase 2 stage.

(d) In any given case where the prospect of a reference arises, it is ultimately for the parties to decide whether to offer undertakings in lieu or to pursue their case in phase 2. The CMA's approach as to whether or not to apply the exception does not remove the parties' choice as to whether or not to offer undertakings in lieu.

Legislative change

2.19 A number of responses noted that the CMA should consider seeking legislative change to change its duty to refer cases where a realistic prospect of an SLC is found. As these comments were not directly relevant to the scope of the current consultation, the CMA has not addressed them further here. However, the CMA is grateful for these comments and will consider these views, to the extent relevant, in any future policy work.

[11] CMA64, paragraphs 22–27.
[12] That is, in any given case where the CMA considers that undertakings in lieu of reference are 'in principle' available (such that the exception is not applied) but are not in fact offered by the parties (such that a reference actually follows and the public costs of a reference are incurred).

Annex A: Questions in the consultation document

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?

Annex B: Respondents

- Adrian Payne Consulting
- Allen & Overy LLP
- Ashurst LLP
- British Institute of International and Comparative Law
- Charles Russell Speechlys LLP
- City of London Law Society – Competition Law Committee
- Cleary Gottlieb Steen & Hamilton LLP
- Clifford Chance LLP
- Debevoise & Plimpton LLP
- Forum of Private Business
- Freshfields Bruckhaus Deringer LLP
- Herbert Smith Freehills LLP
- Law Society of Scotland
- Pennon Group
- Pinsent Masons LLP
- Simmons & Simmons LLP
- Stagecoach Group plc