Guidance on initial enforcement orders and derogations in merger investigations

Summary of responses to the consultation

5 September 2017
CMA60resp

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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 which took over a number of functions formerly performed by the Office of Fair Trading and those of the Competition Commission. 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). Pursuant to section 72 of the Act, the CMA may, before it has reached its decision on whether to make a reference in an anticipated or completed merger, make an initial enforcement order (IEO) in order to prevent or unwind 'pre-emptive action' (ie action that might prejudice the outcome of the reference and/or impede the CMA from taking any appropriate remedial action that might be required). The CMA may subsequently (on application of the parties) grant a derogation, giving consent to the parties to undertake certain actions that would otherwise be prohibited by the IEO.

1.3 The need for an IEO (and the extent to which derogations might be granted) depends on the circumstances of the case. The CMA will balance the need to guard against pre-emptive action against the burdens that IEOs can place on the merging parties.

1.4 In paragraphs 7.28 to 7.31 and Annex C to CMA2,[1] the CMA has described its powers to prevent and unwind pre-emptive action using IEOs, and provided further information in relation to the content and timing of IEOs, the circumstances in which they may be made, and how the CMA will handle requests from merging parties for derogations from specific provisions in an IEO.

1.5 Following a consultation, from 22 March 2017 to 12 April 2017, the CMA is introducing additional guidance (*Guidance on initial enforcement orders and derogations in merger investigations*) to supplement and clarify the guidance in CMA2, reflecting experience gained since the current system was introduced in April 2014.

1.6 This guidance is particularly intended to help merging parties and legal advisers to consider whether a derogation request is necessary, whether a

[1] CMA (January 2014), *Mergers: Guidance on the CMA's jurisdiction and procedure*.

derogation request is likely to be granted, and what information is likely to be required to support a derogation request. In broad terms, the guidance covers:

(a) **The use of IEOs**: including additional guidance in relation to the circumstances in which the CMA will typically impose an IEO in anticipated and completed mergers, and the form that an IEO is likely to take.

(b) **The granting of derogations**: including additional guidance in relation to the process by which derogations will be granted, actions that are not considered to require a derogation, derogations that are likely to be granted by the CMA (where sufficiently specified, reasoned, and evidenced), and derogations that are unlikely to be granted by the CMA (absent exceptional circumstances).

(c) **Timing for imposing and revoking IEOs and granting derogations**: including additional guidance in relation to when the CMA would expect to impose IEOs in anticipated and completed mergers, when merging parties might expect to be released from some or all of the obligations incumbent in the IEO, when an IEO might be released in full, and the practice that is likely to be followed where a merger is referred for a phase 2 investigation.

1.7 The guidance should be read in conjunction with paragraphs 7.28 to 7.31 and Annex C to CMA2. Together with the guidance provided in CMA2, this guidance is intended to set out how and when IEOs are normally used by the CMA (and when derogations to IEOs might be granted). Where there is any difference in emphasis or detail between this guidance and other CMA guidance, the most recently published guidance should take precedence.

Purpose of this document

1.8 The consultation document that accompanied the draft guidance set out a series of specific questions on which respondents' views were sought. This document is intended to summarise the key issues raised by the responses and the CMA's views on these key issues. It is not intended to be a comprehensive record of all views expressed by respondents: respondents' full responses are available on the consultation page.

1.9 This document should be read in conjunction with the consultation document, which contains further background and explanation on the new guidance.

2. Issues raised in the responses to the consultation

2.1 The CMA received seven responses to the consultation, all of which were from legal advisers. A full list of respondents can be found in Appendix A.

2.2 Overall, the majority of respondents supported the introduction of the guidance and agreed that it would provide greater clarity about the circumstances in which an IEO will be imposed, what form it is likely to take, and what the CMA's approach is likely to be to the types of derogations that tend to be most commonly sought in practice. Some respondents identified additional issues upon which it would be useful to clarify the CMA's likely approach. Some respondents suggested that the CMA's existing approach to the imposition of IEOs and the granting of derogations (as reflected in the guidance) should be amended.

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

Proposed scope of guidance

Respondent views

2.4 Respondents generally welcomed the scope of the proposed guidance, noting that it would greatly help to facilitate understanding about the CMA's policy and practice in relation to IEOs and derogations.

2.5 Some respondents considered that the scope of the proposed guidance could usefully be extended. These submissions included proposals that the CMA should:

(a) provide more clarity on the form that the CMA would like derogation requests to take (eg through the provision of a template derogation request);

(b) provide guidance on other elements of the CMA's practice that can be connected to its use of IEOs (eg the use of monitoring trustees and hold-separate managers); and

(c) provide guidance on examples of persons that the CMA will typically accept as suitable to sign compliance statements in lieu of a Chief Executive Officer (CEO).

CMA views

2.6 The CMA agrees that additional guidance on the form that the CMA would like derogation requests to take would be useful. The CMA has therefore made available a template derogation request to accompany the publication of the guidance. Similarly, additional information in relation to persons that the CMA will typically accept as suitable to sign compliance statements in lieu of a CEO has been added to the final version of the guidance.

2.7 The CMA considers that providing guidance on other elements of the CMA's practice that can be connected to its use of IEOs, such as the use of monitoring trustees and hold-separate managers, is beyond the scope of the current consultation exercise. The CMA notes the views expressed that additional guidance in other areas would also be useful and will take these into account in its ongoing assessment of whether changes to its existing guidance, or the provision of additional guidance, might be useful.[2]

The CMA's general practice in relation to use of IEOs in anticipated and completed transactions

Respondent views

2.8 Respondents generally considered that the guidance provides a clear explanation of the CMA's likely approach, and the rationale for that approach, to the use of IEOs in relation to both anticipated and completed mergers.

2.9 Some respondents noted, however, that the CMA should ensure that its approach remains proportionate in the circumstances of each case (given that the imposition of an IEO is a serious step that imposes material costs and restrictions on merging parties). In this regard, some respondents suggested that the CMA's existing approach to the imposition of IEOs (as reflected in the guidance) may be overly onerous.

2.10 For anticipated mergers, some respondents submitted that the position set out in the proposed guidance – that the CMA 'will not usually' impose an IEO in anticipated mergers – risked overstating the likelihood of an IEO being imposed in such circumstances.

2.11 For completed mergers, some respondents suggested that the CMA should not 'normally expect to impose' an IEO, but should rather impose an IEO

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[2] In this regard, the CMA has, as noted in paragraph 4.19 of its Annual Plan for 2017/18, commenced an internal review of the rules and guidance applicable to merger remedies across phase 1 and phase 2 investigations.

where there is a real risk of immediate irreversible harm occurring. Similarly, some respondents suggested that the CMA should provide merging parties with a greater opportunity to engage with the CMA in advance of an IEO being imposed in order to develop a tailored IEO suited to the facts of the case.

CMA views

2.12 The CMA recognises the importance of using its powers under section 72 of the Act proportionately and to avoid imposing unnecessary burdens where possible.

2.13 For anticipated mergers, the CMA has amended the wording of the final guidance to reflect that the circumstances in which the CMA might consider that an IEO is necessary in relation to an anticipated merger are, in practice, relatively rare.

2.14 For completed mergers, the CMA notes the timing constraints that arise when an IEO is imposed post-completion. Given the need to impose an IEO quickly in completed mergers, the CMA would typically not have sufficient time to investigate the specific risks of pre-emptive action arising, or to develop a tailored IEO with merging parties, before imposing an IEO. For this reason, the CMA considers that it would normally expect to impose an IEO in a completed merger and that any IEO imposed in these circumstances will almost always take the form of the standard template available on the CMA's website. Accordingly, discussions over the scope of the IEO in completed mergers will therefore almost always take the form of derogations.

The provision of confidential or proprietary information by the target to the acquirer in the 'ordinary course of business'

Respondent views

2.15 Some respondents suggested that the proposed guidance could more usefully clarify the types of information that can, under the terms of the standard form IEO template, be passed from the target to the acquirer 'in the ordinary course of business' without the need to obtain a derogation. Respondents queried whether compliance with external regulatory obligations was the only purpose for which such information could be disclosed or whether information could also be disclosed for purposes such as the completion of any merger control proceedings relating to the merger or arrangements that are not related to the merger (eg joint contracts/consortia which pre-date the merger).

2.16 Some respondents also suggested the 'strictly necessary' wording used in the standard template IEO template discourages merging parties from 'self-assessing' when considering whether a derogation is necessary for the provision of confidential information by the target to the acquirer (and therefore that merging parties would, in practice, continue to seek the CMA's 'blessing' even where the CMA considers that no derogation should be required).

CMA views

2.17 In the final version of the guidance, the CMA has sought to provide additional information in relation to the circumstances in which the provision of confidential or proprietary information by the target to the acquirer 'in the ordinary course of business' should not require a derogation (under the standard template IEO).

2.18 The CMA notes that the general principle that information should only be shared where 'strictly necessary' is not unique to the standard template IEO.[3] The CMA therefore considers that this standard should not be difficult for merging parties to apply in practice. The CMA also considers that this wording should not, in practical terms, create an unworkably high standard for merging parties seeking to pass confidential or proprietary information for this purpose.

Derogation requests that are likely to be granted by the CMA where sufficiently specified, reasoned, and evidenced

Respondent views

2.19 Respondents generally considered that the guidance provides useful clarification of the types of derogation request that are likely to be granted by the CMA.

Approach to non-UK activities

2.20 Some respondents suggested that the CMA's approach towards derogations in relation to parts of the acquirer's and target's business that have no relevance to the merging parties' relevant activities in the UK 'does not go far enough'. In particular, some respondents suggested that the CMA should

[3] See, for example, Financial Conduct Authority (December 2015), Flows of Confidential and Inside Information.

immediately derogate all non-UK connected activities unless there is a material risk that their integration could give rise to pre-emptive action.

Continued access to key staff where integration is staggered

2.21 In some cases, integration in relation to certain parts of the merging parties' businesses may take place (eg where the CMA has granted derogations that facilitate the integration of the non-UK aspects of the merging parties' businesses) where other parts of their business remain subject to an IEO. One respondent noted that, in such circumstances, the template IEO prevents staff from the parts of the business that remain subject to the IEO from contacting former staff of the target business who are now employed by the acquirer/merged entity.

CMA views

Approach to non-UK activities

2.22 The CMA notes that it would typically be willing to grant derogations that will facilitate the integration of the non-UK aspects of the merging parties' businesses unless necessary to guard against pre-emptive action. The CMA notes, however, that it will usually not be possible to grant such derogations immediately upon imposition of an IEO. This is because the CMA would typically not have had sufficient time to investigate whether the integration of the non-UK aspects of the merging parties' businesses give rise to a risk of pre-emptive action in the specific circumstances of that case.

2.23 The guidance notes that it will, in practice, typically be most straightforward (and therefore quickest) to obtain a derogation in relation to the non-UK aspects of the merging parties' businesses where it is clear that these businesses have no material connection to the functioning of their respective UK businesses.

2.24 The guidance also notes that it may be possible to obtain a derogation where the merging parties' non-UK businesses are active only in relation to products/services in which the CMA has been able to dismiss competition concerns and/or because non-UK businesses would not form part of any remedial action that might be justified by the CMA's decision on the reference are likely to require additional fact-finding. Given the degree of fact-finding that a derogation granted on this basis is likely to require, such derogations are more likely to be granted at a later stage in the CMA's investigation.

Continued access to key staff where integration is staggered

2.25 In the final version of the document, the CMA has sought to provide additional guidance to make clear that it may be willing to grant derogations to enable staff from the parts of the business that remain subject to the IEO to contact key staff members who are now employed by the acquirer/merged entity where necessary to maintain the viability of the target business.

2.26 The CMA notes that merging parties requesting derogations on this basis should be able to show (supported by relevant evidence) why such contacts are necessary (eg to fulfil existing customer agreements or maintain existing customer relationships), and that such contacts are likely to be subject to a number of procedural safeguards.

Derogation requests that are unlikely to be granted by the CMA

Respondent views

2.27 Respondents did not raise material objections in relation to the categories of derogation request that are unlikely to be granted by the CMA (absent exceptional circumstances).

2.28 In relation to the acquirer assuming control of (or material influence over) the commercial policy of the target business, one respondent suggested that the CMA should make clear that it may be possible, in some circumstances, for an 'independent manager of the target' to be appointed to run the target business during the review process.

CMA views

2.29 In the final version of the guidance, the CMA has clarified that an independent manager may, in some circumstances, be permitted to assume direct control over the commercial policy of the target.

Suggested changes to the template IEO

Respondent views

2.30 In addition to comments submitted on the proposed guidance, some respondents suggested potential amendments to the standard template IEO.

2.31 As noted in paragraph 2.16 above, some respondents suggested that the use of the phrase 'strictly necessary' in the standard template IEO dissuades self-

assessment and results in merging parties submitting unnecessary derogation requests to the CMA.

2.32 One respondent suggested that the provision in the standard template IEO that requires the merging parties' businesses to be run 'on the basis of their respective premerger business plans' is 'not particularly helpful when it may be that the most recent business plan has led the target company into economic difficulties.'

CMA views

2.33 As explained in paragraph 2.18 above, the CMA considers that the phrase 'strictly necessary' should not raise material difficulties in interpretation or create an unworkably high standard for merging parties seeking to pass confidential information within the restrictions imposed by the standard template IEO.

2.34 As concerns the provision in the standard template IEO for the merging parties' businesses to be run 'on the basis of their respective premerger business plans,' the CMA again notes (as explained in more detail in paragraph 2.14 above) the need to impose an IEO quickly in completed mergers. For this reason, the CMA would typically not have sufficient time to consider the most appropriate business plan for a target business prior to imposing an IEO. Accordingly, while there may be circumstances in which it is appropriate for the business plan of the target business to be varied, the CMA considers that would be best pursued through a (sufficiently specified, reasoned, and evidenced) derogation request.

Appendix A: Respondents

- Addleshaw Goddard LLP
- Allen & Overy LLP
- Ashurst LLP
- Clifford Chance LLP
- Freshfields Bruckhaus Deringer LLP
- Simmons & Simmons LLP
- Slaughter and May