CLEARY GOTTLIEB STEEN & HAMILTON LLP

LONDON

February 13, 2017

Mergers: Exception to the Duty to Refer in Markets of Insufficient Importance

Response of Cleary Gottlieb Steen & Hamilton LLP

to the Competition and Markets Authority Consultation Document

I. Introduction and Summary

1. This document sets out the response of Cleary Gottlieb Steen & Hamilton LLP to the consultation published by the Competition and Markets Authority (the "**CMA**") on January 23, 2017, on the exception to the duty to refer in markets of insufficient importance (the "**Consultation**").

2. In summary, we agree with the CMA's proposal to increase the *de minimis* thresholds. We also believe that there is an opportunity to make more significant changes to the way that the CMA exercises its discretion in *de minimis* cases. The current system leads to uncertainty and inefficiencies: merging parties face a costly and time-consuming phase 1 investigation before the CMA decides whether to exercise its discretion.

3. We therefore encourage the CMA to introduce an alternative framework that would permit businesses to gain comfort that their transaction meets the *de minimis* exception, without having to undergo a detailed phase 1 investigation. The CMA's Mergers Intelligence Team already considers a large number of cases to determine whether a transaction meets the relevant jurisdictional thresholds and whether it raises *prima facie* competition concerns. The CMA could adopt a similar approach to the application of the *de minimis* exception.

4. For markets of insufficient importance, this framework would allow the CMA to avoid a phase 1 investigation altogether – saving costs for the CMA, the taxpayer, and businesses. Given the expected increase in the CMA's workload once the United Kingdom has left the European Union, these savings assume particular importance.

II. The Legal Framework And The CMA's Guidance

5. The CMA has a duty under the Enterprise Act 2002 (the "**Act**") to refer a relevant merger situation for a phase 2 investigation where it believes there is a realistic prospect of a substantial lessening of competition.

6. The CMA, however, has discretion under ss. 22(2) and 33(3) of the Act not to make a reference where the markets concerned are of insufficient importance (the *de minimis* exception). The Act does not specify the criteria for exercising this discretion.

7. The CMA has published guidance on how it applies the *de minimis* exception. The material parts of the most recent guidance, from December 2010, provide as follows:[1]

   - If the size of the market(s) concerned are less than £3 million, the case will not justify the costs of a phase 2 reference (unless there are exceptional circumstances).

   - If the size of the market(s) concerned are greater than £10 million, the case will generally justify the cost of a phase 2 reference.

   - If the size of the market(s) concerned are between £3 million and £10 million, the CMA conducts a cost/benefit analysis to assess whether the consumer harm expected to result from the merger is greater than the average public cost of a reference to phase 2 (estimated in 2010 to be around £400,000, and today likely to be significantly higher given that phase 2 investigations are increasingly evidence- and resource-heavy).

8. The cost/benefit analysis for markets in the bracket between £3 million and £10 million currently takes place during phase 1 and considers three issues:

   - First, whether undertakings *in lieu* of a reference could in principle be offered to address any concerns; if so, the *de minimis* exception will not apply.

   - Second, whether the customer harm potentially resulting from the merger will outweigh the public costs of a reference. This assessment takes into account the size of the market, the strength of competition concerns, the magnitude of competition that would be lost by the merger, and the durability of the merger's impact.

   - Third, whether a reference would be proportionate given the wider implications of the decision for future cases. The exception is less likely to apply if the merger is one of a potentially large number of similar mergers that could occur across the sector in question.

---

[1] Mergers: Exceptions to the duty to refer and undertakings *in lieu* of reference guidance, December 2010, OFT1122 ("**Exceptions Guidance**").

III. The Questions Raised In The Consultation

9. The Consultation proposes to increase the *de minimis* thresholds as follows:

   - The upper-bound threshold will increase from £10 million to £15 million.
   - The lower-bound threshold will increase from £3 million to £5 million.

10. The CMA believes this proposal would result in two benefits. First, it could result in a reduction in costs for the CMA in investigating phase 1 and phase 2 mergers. Second, there could be a reduction in the burden of merger control on businesses, which will have wider scope to self-assess and avoid a notification altogether, as well as better chance avoiding a phase 2 reference.

11. The questions raised in the Consultation are as follows:[2]

   - Do you agree with the proposed changes to the thresholds?
   - Do you agree with the potential benefits of these proposals?
   - Do you have any other comments about the proposed changes?

IV. Our Response To The Questions Raised In The Consultation

12. We agree with the proposal to increase the thresholds. We also agree that increasing the thresholds has the potential to reduce the CMA's costs, as well as the burden faced by businesses.

13. We would recommend, however, that the proposed changes go further. Even with the proposed changes, the current system may not allow businesses "*to take comfort that the exception could apply to them*," so as to avoid a notification.[3]

14. This is because, when the concerned markets are in the £3 million to £10 million bracket (or, if the proposals are implemented, the £5 million to £15 million bracket), the analysis of whether the exception will apply essentially turns on the substantive assessment of the merger. In considering the application of the *de minimis* exception, the CMA conducts a detailed assessment of whether the merger is likely to lead to customer harm.[4] In practice, this may differ little from an assessment of whether the merger will

---

2 The Consultation, ¶2.

3 The Consultation, ¶1.21(b)(i).

4 *See* discussion in the Exceptions Guidance, ¶¶2.28-2.39, on assessing the "*expected customer harm from the merger*".

result in a substantial lessening of competition.[5] In most cases, businesses are unlikely to know, *ex ante*, whether they qualify for the exception.[6]

15. In addition, the fact that undertakings *in lieu* are in principle available is not, in our view, an appropriate consideration to disapply the *de minimis* exception. First, mergers raising the same substantive concerns may be treated differently, depending on whether remedies are in principle available or not. Second, the assessment requires a detailed analysis of both substance and remedy, which undermines the point of the exception as a means to save time and expense. Third, it creates a dilemma for the parties who may have incentives to argue that no in principle remedies exist during a phase 1 investigation, in order to increase the chance of a *de minimis* clearance, but then face the prospect of a phase 2 reference unless they can offer remedies *in lieu*.[7]

16. The stage in the process at which the CMA decides whether the *de minimis* exception applies exacerbates these problems. Currently, the CMA takes this decision at the end of phase 1. This typically comes after months of investigation. It defeats the object of the exercise if, at the end of that process, it becomes clear that the merger should not be referred because the *de minimis* exception applies.

17. Thus, for mergers in markets with a size of £3 million to £10 million (or £5 million to £15 million) and, exceptionally, in smaller markets, the main benefits outlined by the Consultation often do not arise:[8] the CMA's costs at

---

5 *See, e.g., Orbital Marketing Services Group/Ocean Park Ltd*, OFT decision of November 14, 2008, ME/3863/08 (*de minimis* exception applied for a 2 to 1 merger of tour brochure distributors because anticompetitive effects were not significant due to (i) countervailing buyer power, (ii) the likely future exit from the market of one of the distributors, and (iii) the limited competition between the distributors pre-merger); *Go North East/Arriva Northumbria*, OFT decision of May 26, 2010, ME/4288/09 (*de minimis* exception applied for a 2 to 1 merger of North East local bus service providers because while there were no other competitors on concerned routes, other bus services were prominent in the surrounding region); and *Stagecoach Bus Holdings/Cavalier Contracts Ltd*, OFT decision of September 18, 2008, ME/3703/08 (*de minimis* exception applied because any price increases resulting from the merger would not be significant due to (i) Stagecoach's limited ability to increase prices on multi-operator tickets, (ii) the constraint on Stagecoach's own tickets posed by multi-operator tickets, and (iii) the role played by the council in limiting and vetoing price increases).

6 This detailed assessment may (in exceptional circumstances) also be undertaken when the markets concerned are less than £3 million. *See, e.g., Diamond Bus Company/ Firstgroup plc*, OFT decision of August 23, 2013, ME/5996/13 (no reference for a 2 to 1 merger in certain local bus routes based on the limited magnitude and durability of harm, due essentially to the possibility of entry; the OFT conducted detailed review of the transaction, including assessment of failing firm counterfactual, analysis of tender data, reviewing route metrics, likelihood of entry or expansion, and third-party evidence (¶¶126-127)).

7 It also conflicts with the CMA's recommendation that merging parties consider possible undertakings *in lieu* during pre-notification and in the early stages of the CMA's assessment. *See* Mergers: Guidance on the CMA's jurisdiction and procedure, January 2014, CMA2,¶8.7.

8 The Consultation, ¶1.21.

phase 1 are not reduced because firms feel obliged to notify anyway; and businesses still face the significant costs of undergoing a phase 1 investigation.

18. We consider that clearer and more predictable guidelines are needed. One possible approach would be as follows:

    - For markets below £5 million, no reference will be made.

    - For markets between £5 million and £15 million, no reference will be made unless the parties' share of supply exceeds a pre-defined safe harbour (*e.g.,* 50%), and there is an increment to that share. If the combined share is above that level, the CMA will carry out a cost/benefit analysis, as it does today, without any presumption as to whether the merger would result in a substantial lessening of competition or whether the *de minimis* exception should apply.

    - For markets above £15 million, the *de minimis* exception will generally not apply.

19. The CMA's Mergers Intelligence Team already considers a large number of cases to determine whether a transaction meets the relevant jurisdictional thresholds (including the share of supply test) and whether it raises *prima facie* competition concerns. The CMA could adopt a similar approach to the application of the *de minimis* exception.

20. The CMA could enquire whether the *de minimis* thresholds apply. Businesses would also be able to submit a short letter explaining why the *de minimis* exception should apply, based on the above thresholds. This would allow the CMA to assess whether the exception applies before, and without, undertaking a full phase 1 investigation. If the CMA determines that exceptional circumstances apply, such that the CMA will not exercise its discretion under *de minimis* exception, it would communicate that to the parties at the outset.

21. Businesses can thus gain comfort that they fall within the exception and would not need to notify. At the same time, the CMA would save costs by not investigating mergers in phase 1 that would ultimately meet the *de minimis* exception.

22. Finally, these matters assume particular importance given the expected increase in the CMA's workload with the United Kingdom's departure from the European Union. The CMA estimates that it could face an additional caseload of between 30 to 50 phase 1 mergers each year (as well as half a dozen in-depth phase 2 inquiries), representing an increase of 40-50%.[9] Andrea Coscelli

[9] Competition and Markets Authority, *Andrea Coscelli on the CMA's role as the UK exits the European Union*, available at: https://www.gov.uk/government/speeches/andrea-coscelli-on-the-cmas-role-as-the-uk-exits-the-european-union

has spoken of the CMA's aim to be "*ready and equipped to deal with such an increase.*"[10] A revised framework for the application of the *de minimis* exception, as proposed above, could contribute towards that goal.

23. We trust that this is responsive to the CMA's Consultation. We stand ready to provide any further assistance.

* * *

CLEARY GOTTLIEB STEEN & HAMILTON LLP

[10] *Ibid.*