CMA's Consultation on draft guidance in relation to the use of initial enforcement orders (*IEOs*) and the derogations that might be granted to IEOs

(22 March 2017)

Response by Freshfields Bruckhaus Deringer LLP

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RESPONSE TO THE CMA'S CONSULTATION ON

DRAFT GUIDANCE IN RELATION TO THE USE OF IEOS AND THE DEROGATIONS THAT MIGHT BE GRANTED TO IEOS

of 22 March 2017

1. Introduction

1.1 Freshfields Bruckhaus Deringer LLP (***Freshfields***) welcomes the opportunity to comment on the CMA's consultation on the 'draft guidance in relation to the use of IEOs and the derogations that might be granted to IEOs' of 22 March 2017 (the ***Draft IEO Guidance***) and the related consultation document (the ***Consultation Document***).

1.2 Our comments below are based on our substantial practical experience of merger control regimes across Europe, the US and Asia over several decades. In particular, Freshfields has significant experience with CMA cases involving IEOs. However, the comments in this response do not purport to represent the views of our clients.

1.3 Terms defined in the Consultation Document or Draft IEO Guidance have the same meaning in this response.

2. Question a): Does the guidance generally provide sufficient information in relation to the CMA's practice in relation to IEOs and derogations (in particular as concerns process and timing)? Are there any aspects of the CMA's practice on which further information would be useful?

A. General comments on the CMA's IEO process

2.1 Freshfields welcomes the CMA's willingness to provide further clarification and guidance on the use of IEOs and on derogations to such IEOs. As a whole, the Draft IEO Guidance is a very useful document that will provide additional information to companies facing IEOs and external advisers advising on the legal implications of such IEOs.

2.2 The UK merger control regime, however, remains non-suspensory and voluntary. This is a significant asset (in particular in terms of enforcement flexibility) compared to other jurisdictions and should be maintained.[1] The use of IEOs following the reform of the UK's competition regime in 2013/14 should therefore be consistent with the voluntary character of the regime and targeted to those parts of transactions which give rise to a prospect of the likely use of the CMA's remedy powers.

2.3 We commented extensively on the risk of using IEOs as a means to create a quasi-suspensory regime in the UK and warned against an extensive use of the CMA's power to issue IEOs in that context.[2] Based on our experience of the operation of

[1] The Government itself acknowledged this in its response to the consultation no the revised competition regime in 2012 by stressing the proportionality of the voluntary regime and its more limited burden on business (compared to a mandatory regime) – cf. Department for Business, Innovation & Skills, "Growth, competition and the competition regime", government response to consultation, March 2012, paras. 5.3 et seq.

[2] See response to CMA's consultation on its CMA2 guidance on jurisdiction and procedure submitted by Freshfields Bruckhaus Deringer LLP on 6 September 2013 (the ***CMA2 Submission***), paras. 2.7 et seq.

IEOs, many of the potential issues we highlighted in our CMA2 Submission have arisen in practice. The IEO process is in practice complex and puts significant administrative burdens on companies subject to IEOs, their advisers, and, ultimately, the CMA. Costs relating to the IEO process are significant.

2.4 By way of example, we typically have to allocate specific legal resource solely to the process of advising on the reach of IEOs and the derogation process that is required to allow parties to a transaction to continue carrying on their businesses. We have faced cases where parties had to request derogations on more than 50 individual grounds from the CMA just within phase 1. We do not consider that the operation of the CMA's powers to issue IEOs in this manner is proportionate, in the public interest or an efficient use of the CMA's resources.

2.5 In our view, the CMA should carefully consider whether an IEO is really required before issuing one. The same applies to the extent of each IEO that is issued. In some instances, the IEO imposed by the CMA leads to a degree of separation and regulatory scrutiny that is further reaching than is normally required in suspensory regimes (e.g., the need to pre-clear any sharing of information and/or the precise nature of information with the CMA prior to sharing). This does not appear to be compatible with the notion of a non-suspensory regime. In that light, while we recognise and welcome that the Draft IEO Guidance provides helpful clarifications, in our view it is in many instances not sufficiently ambitious in providing real guidance that will alleviate the burden on parties and the CMA arising from the way in which the CMA currently applies its powers (and we will outline this in more detail below).

2.6 Furthermore, although day-to-day cooperation with CMA case teams is open and constructive, we frequently encounter inconsistent handling of the IEO process and derogation requests in practice. Our experience is that whereas one case team might be willing to take a pragmatic view on derogation requests, other case teams adopt a different, and more rigid, approach (both in terms of timing and in terms of handling the content of IEOs as well as whether and to what extent derogations are granted). While the Draft IEO Guidance should support a more consistent CMA practice, we invite the CMA to ensure a consistent application of the same principles by way of internal oversight and the sharing of practical experience. Our experience is that approximately 90% of all derogation requests submitted to the CMA in respect of an IEO are eventually granted. This illustrates both that derogations are very important to parties in practice and that flexibility is, indeed, required and justified in considering derogation requests.

B. Specific comments on the Draft IEO Guidance

Use of IEOs in anticipated mergers

a) IEOs should be used only in exceptional circumstances for anticipated mergers

2.7 The CMA's Draft IEO Guidance sets out that the CMA will *'not usually'* impose an IEO in respect of an anticipated merger, and then goes on to explain that instances of IEOs in anticipated mergers are '*relatively rare*'.[3]

[3] Draft IEO Guidance, paras. 2.2-2.4.

2.8 We agree that IEOs should indeed be rare in relation to anticipated mergers. But our concern remains that the CMA's Draft IEO Guidance should be consistent with a policy of carefully targeted intervention within a voluntary regime. In this context, we suggest that the Draft IEO Guidance makes clear that, in the context of anticipated mergers, IEOs will be imposed in only the most exceptional of circumstances (as opposed to '*not usually*' in the current draft).

b) The use of 'tailored' IEOs in anticipated mergers

2.9 Freshfields agrees with the CMA's position of being open to 'tailored' IEOs in relation to anticipated mergers.[4] Indeed, given that the use of IEOs for anticipated mergers should be exceptional, it would be inconsistent to apply a blanket "standard form" IEO approach. For anticipated mergers, the extent of any IEO should be carefully crafted to go no further than protecting the exceptional requirements that the CMA considers justify issuing the IEO in the first place.

2.10 It follows that we do not agree with the CMA's position in the Draft IEO Consultation that tailored IEOs in relation to anticipated mergers will be considered only '*exceptionally'*.[5] We suggest that the CMA should give parties a period of five working days to suggest and agree a tailored IEO (including structures such as ring-fencing, hold separate trustees and the like) with the CMA in all anticipated merger situations.

c) Other comments relating to anticipated mergers

2.11 Finally, we suggest to consider moving paras. 2.13-2.15 of the Draft IEO Guidance up after para. 2.4, as they deal with the use of IEOs in anticipated mergers (and not completed mergers).

Use of IEOs in completed mergers

a) IEOs should be used less frequently in completed mergers

2.12 The CMA's Draft IEO Guidance is consistent with our practical experience in relation to the use of IEOs in completed mergers insofar as that the CMA states that it '*normally*' imposes IEOs and that these IEOs '*almost always*' take the form of the standard IEO template.[6]

2.13 We submit, however, that, to recognise appropriately the non-suspensory character of the UK merger control regime, the CMA should be more discriminating when considering whether to impose IEOs in completed merger situations. Instead of '*normally*'[7] issuing an IEO, the CMA has the ability to intervene where it appears justified to do so (for example, where there is a real risk of immediate irreversible harm occurring), and indeed this is the underlying statutory position. The CMA's current approach is a blunt instrument, and is disproportionate to the limited number of cases in which there is actually any material risk of immediate and irreversible pre-emptive action. We consider that this leads to worse market outcomes given that the benefits of preventing irreversible pre-emptive action in that small minority of cases

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[4] Draft IEO Guidance, paras. 2.13 et seq.

[5] Draft IEO Guidance, para. 2.13.

[6] Draft IEO Guidance, paras. 2.5 et seq.

[7] Draft IEO Guidance, para. 2.6.

are to be set against the risk that the costs and delays associated with the IEO (and derogation) process affect the target businesses' ability to compete and to obtain cost synergies and efficiencies from the relevant transaction which would otherwise be passed on to UK consumers more quickly.

b) The CMA should not 'almost always' rely on the template IEO in completed mergers

2.14 Equally, we respectfully disagree with the CMA's practice (as outlined in the Draft IEO Guidance) to '*almost always*' rely on the template IEO in completed mergers.[8] While it may be helpful to refer to the template order as a starting point, the CMA should give parties a greater opportunity to engage with the CMA in advance of any orders being imposed to agree interim measures specifically tailored to the facts of their case. In our view, a tailored IEO would deal with the actual risks of immediate irreversible harm more effectively while at the same time eliminating, or at least minimising, the need for numerous discussions around derogation requests (which are costly, time consuming, and not an efficient use of the CMA's resources). The current approach routinely puts parties subject to the order in breach from the outset until a first set of derogations is granted, which is a highly unsatisfactory position in administrative law terms.

c) Suggested changes to template IEO

2.15 The CMA's reliance on the template IEO might not always lead to an effective outcome that protects both competition in the market and the value of the target company.[9] Specifically, the usual restriction of running the target business as set out in its most recent business plan preceding the merger is not particularly helpful when it may be the most recent business plan that has led the target company into economic difficulties (e.g., in a "failing" or "flailing" firm scenario).

d) The use of other interim measures

2.16 Moreover, the Draft Guidance mentions the occasional need to put in place other interim measures (such as hold-separate managers or monitoring trustees).[10] We recognise that very exceptionally such other interim measures may be justified but in these cases further guidance on the role and responsibilities of such appointees, their interplay with CMA decision making and the circumstances in which the CMA would, or would not, follow their independent advice could helpfully be expanded upon in the final guidance. We have encountered situations where the hold-separate manager or monitoring trustee gave very clear recommendations on how to run the target business which were then disregarded by the CMA in circumstances where it was not clear on what basis the CMA had made that decision.

Granting of derogations - general remarks

2.17 The CMA's Draft IEO Guidance indicates that the CMA will strive to deal with derogation requests as efficiently as possible, and our experience is consistent with that.[11] Based on our experience, the average processing time (i.e., the time between

8 Draft IEO Guidance, para. 2.9.
9 Draft IEO Guidance, para. 2.9.
10 Draft IEO Guidance, para. 2.12.
11 Draft IEO Guidance, paras. 3.1 et seq.

the formal request and the granting of a derogation by the CMA) is somewhere between two and four working days. In most cases, this will be a sufficiently prompt response, and we welcome the CMA's willingness to take derogation requests seriously and process them efficiently (in particular where they have been classed as urgent).

2.18 At the same time, we have however also encountered instances where, even though a derogation request was urgent and referred to as such, the processing time by the CMA exceeded the average significantly. This was frequently stated to be due to internal sign-off from senior CMA staff being required before the case teams were able to proceed. While the need for senior oversight and approval is understood and accepted, it would be beneficial to the operation of the system if the CMA could indicate target timing for its internal decision-making processes relating to IEOs to ensure a timely and consistent processing going forward. This would help manage the significant administrative burden on, and business planning challenges for, parties caused by the IEO/derogation process.

Remarks in relation to categories where derogations are likely to be granted

2.19 We generally agree with categories of derogations that are likely to be granted by the CMA as set out in the Draft IEO Guidance and we welcome the additional guidance provided in this respect. We have encountered all of these categories frequently in practice. There is often a need for these derogations because the matters which most frequently require derogations are not sufficiently addressed by tailored terms in the IEOs at the outset. The most efficient way to deal with these matters is likely to be tailoring the terms of the IEO in the first place (see above paras. 2.9-2.10 and 2.14). However, on the basis of the current "standard" template IEO, our specific comments and some additional proposals in respect of derogations are set out below.

a) In relation to the category 'provision of certain financial information for legitimate transaction execution purposes'[12]

2.20 One very important category of derogation requests falling under this heading is the access to and sharing of information that is required for compliance with reporting obligations and regulatory obligations (including compliance with risk management obligations such as reporting to an oversight body under professional standard rules). The current wording of the Draft IEO Guidance *'(for example where required for compliance with external regulatory and/or accounting obligations)'* is supposed to capture that.

2.21 We would, however, like to suggest highlighting this point in the guidance as this situation is at least as frequent in practice as '*legitimate transaction execution purposes*'. Against this backdrop, we would also suggest adding the wording '*for legitimate transaction execution purposes <u>or to comply with regulatory (or similar) obligation</u>*' (emphasis added) to the heading of this category.

2.22 In relation to the same category of derogations likely to be granted, para. 3.9 of the Draft IEO Guidance currently refers to certain categories of information sharing strictly necessary in the ordinary course of business as follows: '*The CMA notes, however, that passing this kind of information for this purpose should not require a*

[12] Draft IEO Guidance, paras. 3.8 et seq.

derogation and therefore encourages merging parties to apply for a derogation only if the information flow envisaged would exceed what is strictly necessary for this purpose.'[13]

2.23 While we welcome the clarification that parties should not be required to request a derogation for information exchanges that are clearly necessary and justified, the following paragraph 3.10 of the Draft IEO Guidance appears to contradict and undermine this helpful stance. It reads: '*This exception must, however, be strictly construed. Only information that is strictly necessary for compliance with specific obligations of this type can be disclosed, and such information can only be shared with the individuals who strictly require the information in order to ensure compliance with those obligations. (…)*"[14]

2.24 If the CMA retains this wording in the final guidance, the practical effect will be that parties will continue to seek an express derogation from the CMA to obtain clarity, as they will be advised that the CMA's policy is to be "strict" in this respect. Unless the CMA makes a much clearer statement that derogations are not required in this very common situation, the new guidance will not bring about any change of practice for merging parties. We therefore suggest the deletion of paragraph 3.10 of the current Draft IEO Guidance.

2.25 We agree with the CMA's stance that the disclosure of information should in most cases be protected by putting a number of procedural safeguards in place.[15] However, footnote 16 of the Draft IEO Guidance currently reads: '*The detailed aspects of such arrangements (eg the wording of non-disclosure agreements) will typically be reviewed in advance and approved by the CMA.*'

2.26 We suggest that this footnote contradicts the CMA's intention that the parties should self-assess and decide where derogations are not required.[16] It is inconsistent for the CMA to contemplate that parties and their external advisers could decide that certain categories of information can be exchanged within established procedural safeguards, to then face micro-management and an approval of this process by the CMA in advance.

2.27 Against this backdrop, we suggest the deletion of footnote 16 of the Draft IEO Guidance entirely in the interest of promoting legitimate self-assessment and improving the efficiency of the IEO process.

b) In relation to the category of 'carve-outs of the non-UK business from the IEO'[17]

2.28 This category is of significant importance to parties in practice. It is also of significant jurisdictional importance. The use of IEO powers should not result in the delay of completion of a global transaction while the CMA considers its impact on UK markets. The CMA should therefore, as a rule, be willing to grant this derogation, unless it has clear evidence of a particular threat for competition in the UK resulting from business integration outside the UK.

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13 Draft IEO Guidance, para. 3.9.
14 Draft IEO Guidance, para. 3.10 (emphasis added).
15 Draft IEO Guidance, para. 3.14.
16 Cf. Draft IEO Guidance, para. 3.9 and Question d) of the Consultation Document.
17 Draft IEO Guidance, paras. 3.24-3.26.

2.29 We would therefore suggest either to rephrase the model IEO accordingly or, at least, to rephrase paragraph 3.24 to state '*the CMA will, unless it has clear evidence of a particular threat to competition in the UK resulting from integration outside the UK, grant derogations…*' instead of '*the CMA may, in some cases, grant derogations…*'. (emphasis added).

c) In relation to the category of 'replacement of key staff'[18]

2.30 Changes to key staff are frequent following a completed merger, and the current requirement to obtain derogations is burdensome for the parties. We, therefore, suggest the CMA considers loosening this requirement, e.g., by allowing changes to staff within the ordinary course of business and under certain conditions (such as no transfer from acquirer to target or *vice-versa*) to go ahead without any derogation being required. This would minimise the burden on the parties significantly and thus accelerate proceedings, allow the CMA to focus on the competitive assessment of the case at hand, and reduce costs for everyone involved.

Remarks in relation to categories where derogation requests are unlikely to be granted

2.31 We understand the CMA's position that a number of categories of derogation requests can only be granted in exceptional circumstances. We are, however, also of the view that certain exceptions from these categories of derogations unlikely to be granted should receive more prominence than it is the case in the current Draft IEO Guidance.[19]

2.32 The CMA's Draft IEO Guidance refers explicitly to measures that '*safeguard the viability of the target business*':[20] We agree that it is necessary to introduce this exception, and based on our experience, the CMA is generally willing to allow a larger influence over target business if this necessity to protect the target's viability is shown.

2.33 In order to give effect to this consideration, the CMA should also consider adding one additional category where submissions about the viability of the target business would be considered.

2.34 The CMA should consider adding the possibility for the acquirer to appoint an independent manager of the target to run the target business during the review period. Frequently, the current system leads to the acquirer actually having to pay for the (failing) target business, with incumbent target management facing neither oversight nor any directional steer on how to improve the running of the target business. It is not clear that this outcome is either consistent with the CMA's statutory objectives underpinning the IEO process, or in the interests of UK consumers. Our proposal would help to alleviate this concern.[21]

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18 Draft IEO Guidance, paras. 3.27-3.32.

19 As set out in Draft IEO Guidance, para. 3.36.

20 As set out in Draft IEO Guidance, para. 3.36.

21 Finally, the cross-reference in the last sentence of para. 3.36 to '*paragraph 3.29 above*' should read '*paragraph 3.35 above*', as it refers to exceptions from derogation requests unlikely to be granted set out in para. 3.35 of the Draft IEO Guidance (cf. Draft IEO Guidance, para. 3.36).

Timing of imposing and revoking initial enforcement orders and granting derogations

2.35 The Draft IEO Guidance notes the CMA's willingness to revoke an IEO as soon as it is clear that a transaction will not give rise to competition concerns.[22] We welcome this clarification, as in those circumstances, there can be no legal or policy justification for retaining an IEO in place. In our experience, the current practice of the CMA is not consistent in this respect, and some case teams have left IEOs in place even after it has become clear that the transaction causes no competition concerns.

2.36 We also welcome the CMA's Draft IEO Guidance insofar as that it indicates a willingness to consent to completion on a global level as long as safeguards (such as hold-separate arrangements and a monitoring trustee) are in place to prevent pre-emptive action in the UK.[23] Consistent with our remarks in paras. 2.28-2.29 above, the use of IEO powers should not result in the delay of completion of a global transaction while the CMA considers its impact on UK markets. We suggest either to rephrase the model IEO accordingly or, at least, to rephrase paragraph 4.6 to state "*The CMA will, unless it has clear evidence of a particular threat to competition in the UK resulting from integration outside the UK, consent to completion…*" instead of "By exception, the CMA may be willing to consider…" (emphasis added)

2.37 In addition, we suggest that the CMA should consider a geographical carve-out not only in phase 2, but actually at all times during its investigation. We would, therefore, suggest to move the sentence '*By exception, (…) are put in place in order to prevent pre-emptive action.*'[24] into a separate paragraph to clarify that this option will be considered at all times, and not just in phase 2.

22 Draft IEO Guidance, paras. 4.2 et seq.

23 Draft IEO Guidance, para. 4.6.

24 Ibid.

3. Question b): Are there any other significant examples of derogations that stakeholders consider should typically be granted by the CMA where sufficiently specified, reasoned, and evidenced?

3.1 In addition to the specific comments on the current Draft IEO Guidance set out in response to Question a) above, we would suggest a number of additional categories where the CMA should typically grant derogations from IEOs.

Derogations regarding access to key staff

3.2 We invite the CMA to consider adding a new category of derogations that should typically be granted relating to '*access to key staff*' (e.g., as category (f) in para. 3.6 of the Draft IEO Guidance).

3.3 Where integration has already taken place (e.g., in jurisdictions that are outside the scope of the IEO) and where former target personnel are now employed by the acquirer/merged entity, the ring-fencing provisions under the IEO prevent the target business from contacting these key staff members. At the same time, access to these key staff members may well be vital to maintain the viability of the target business by allowing it to fulfil existing customer agreements and maintain existing customer relationships(e.g., in relation to product support). In this instance, derogations from the ring-fencing provisions under the IEO should typically be granted (provided that safe guards such as non-disclosure agreements are put in place).

Derogations regarding merger notices and in relation to joint contracts

3.4 We would also invite the CMA to consider adding additional categories of 'derogations likely to be granted' relating to (i) the completion of the merger notice and information exchange relating to the merger control process overall; and (ii) relating to the exchange of information and the decision-making process in the context of pre-existing joint contracts or consortia situations.

3.5 Both are discrete scenarios where there is a justifiable need for the exchange of information and cooperation "across the hold-separate" imposed by the IEO. Potentially, these additional clarifications would "sit" best in the guidance to category (a) 'provision of financial information' in paras. 3.8-3.14 of the Draft IEO Guidance.

Granting of "umbrella derogation requests"

3.6 Based on our experience, the CMA has in some instances been willing to grant so-called "umbrella derogations" that set out certain categories of decisions for which individual derogations would typically not be required for the individual case.

3.7 We very much welcome this approach. It adds a greater degree of flexibility to the derogation process, and reduces the administrative burden for parties and the CMA alike. The Draft IEO Guidance does, however, not mention the CMA's willingness to consider such "umbrella derogation requests" for individual cases. We would therefore suggest adding guidance, which reflects current practice, in this respect.

4. Question c): Are there other specific actions that arise commonly in practice in relation to which further guidance on the CMA's likely approach would be useful?

4.1 See the points raised in response to Questions a) and b) above.

5. Question d): Do merging parties and their legal advisers consider themselves able to 'self-assess' in relation to contemplated actions that should not require a derogation? If not, what additional information would be useful to help merging parties and their legal advisers make this kind of assessment?

5.1 Assessing (i) whether an intended action falls under an IEO or not; (ii) whether it requires a derogation or not; and (iii) making the required reasoned submission and answering the CMA's responses to these is a burdensome, time-intensive and costly process.

5.2 Target businesses are frequently not represented by their own external counsel during CMA proceedings, particularly where a transaction has been completed. They require a significant degree of education and guidance. The more detailed the CMA's guidance is and the more consistent its practice in relation to IEOs will develop over time, the easier self-assessment will become.

5.3 In some instances, the CMA's Draft IEO Guidance in its current form creates additional uncertainty that undermines the parties' ability to self-assess – see, for example, paras. 2.23-2.24 above in relation to the "strict" interpretation of necessary information exchanges. We invite the CMA to remove any ambiguity that might undermine the ability to self-assess from the final guidance.

Freshfields Bruckhaus Deringer LLP

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