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The City of London Law Society

Competition Law Committee

RESPONSE TO: The Competition and Markets Authority ("CMA") Consultation "Mergers: Exception to the duty to refer in markets of insufficient importance"

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RESPONSE TO THE CMA'S CONSULTATION ON "MERGERS: EXCEPTION TO THE DUTY TO REFER IN MARKETS OF INSUFFICIENT IMPORTANCE"

1 Introduction

1.1 This response is submitted by the Competition Law Committee of the City of London Law Society ("**CLLS**") in response to the CMA's consultation on (the "**Consultation Paper**"), published on 23 January 2017.

1.2 The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

1.3 The Competition Law Committee members who prepared this response were:

- Ian Giles (Partner, Norton Rose Fulbright LLP and Chairman, De Minimis Consultation Working Party);
- Robert Bell (Partner, Bryan Cave LLP, Chair, CLLS Competition Law Committee);
- Angus Coulter (Partner, Hogan Lovells LLP).

1.4 The CLLS welcomes the opportunity to respond to the Consultation Paper. It is critical that the CMA considers carefully the scope of its jurisdiction to review transactions which have an impact within the UK. This consultation goes to the question as to the lower bounds of the CMA's remit to review such transactions. The view of the CLLS is that – in particular in the context of the impending UK exit from the EU, and expected impact this will have on the resource constraints facing the CMA – the CMA should carefully consider whether the modest changes proposed in the Consultation Paper are adequate to ensure the CMA has sufficient resource for the potentially larger challenges ahead.

1.5 Instead, and in line with international practice in comparable jurisdictions, the CLLS believes the CMA should consider whether its "de minimis" threshold should be set at a materially higher level, and whether changes should be made to replace the *duty* to refer with a *discretion* to refer (ss.22 and 33 of the Enterprise Act 2002), which would also give the CMA a better ability to manage its resources with regard to smaller transactions.

1.6 In particular, the CLLS proposes that:

(i) The CMA removes the current £10 million higher threshold for markets which it will generally not consider to be of sufficient importance to justify a reference; and

(ii) The CMA materially increases the current £3 million lower threshold for markets where the CMA will generally not consider a reference

justified to at least £15 million (which would be broadly in line with the €15 million threshold applied in Germany).

1.7 We set out responses to the specific points raised in the Consultation Paper below.

2 Response to Questions for Consideration

Q.1 Do you agree with the proposed changes to the thresholds?

Background

2.1 The CMA is proposing to update its guidance to:

(a) increase the market size threshold over 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.

2.2 In our view, these increases are insufficient to address the concern that UK merger control places too much emphasis on smaller transactions, and that the burden of a reference is disproportionate in the context of such smaller transactions. In particular: (a) the proposed increases to the market size thresholds are in fact minimal, once the rate of inflation since 2010 is taken into account; and (b) other comparable, well-established jurisdictions rely on considerably higher turnover thresholds or *de minimis* market tests, which minimise the risk of less significant mergers being caught by the timing and cost implications of merger control review.

Impact of inflation

2.3 The current thresholds were introduced by the OFT in December 2010 in its guidance, *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference* (OFT1122). The impact of inflation alone on the figures included in the OFT document would justify increases from £10 million to £12 million, or from £3 million to £3.5 million. The proposed increases (to £15 million and £5 million), factoring in inflation, are therefore even less significant than they appear ostensibly.

Comparator regimes

2.4 More significantly, the question is whether these are appropriate thresholds for a major economy such as the UK to be applying to an intrusive merger control regime which – in particular where a reference is made – imposes significant burdens upon the parties, and uses significant public resource in terms of the costs of carrying out the reference.

2.5 By way of comparison, we have considered the minimum levels of revenue under which comparator international regimes would have jurisdiction to intervene in the context of a merger of duopolists producing a single product type – that is where the total market size would be reflected in the total revenues of the two parties merging. Such cases would result in the creation of a monopoly – not typically a preferred competitive outcome, but one which by virtue of the relatively small size of the participating companies, would be considered outside the merger control jurisdiction of local competition authorities.

(a) **Germany:** Under current rules, a transaction is only notifiable in Germany where (among other criteria) one party to the transaction achieves turnover in Germany of

€25 million, and the other achieves turnover of €5 million, in other words the German authority would be unable to intervene in a merger of single-product duopolists where the market size in Germany was below €30 million (c.£26 million);

(b) **France:** For a transaction to be notifiable (among other criteria), at least two participating companies are required to have French turnover of €50 million for a transaction to be notifiable. In other words the French authority would be unable to intervene in a merger of single-product duopolists where the market size in France was below €100 million[1] (c.£86 million);

(c) **Italy:** For a transaction to be notifiable (among other criteria), the combined revenue of the parties in Italy exceeds €495 million, with the target achieving Italian revenues of at least €50 million. In other words the Italian authority would be unable to intervene in a merger of single-product duopolists where the market size in Italy was below €495 million (c.£425 million);

(d) **Japan:** For a transaction to be notifiable (among other criteria), the Japanese turnover of one the merging parties must be at least ¥20 billion, and at least ¥5 billion for a second party to the transaction. In other words the Japanese authority would be unable to intervene in a merger of single-product duopolists where the market size in Japan was below ¥25 billion (c.£176 million).

2.6 Whilst we recognise that the examples above are not exhaustive, they are informative as to the thresholds for intervention applied by similar-sized economies in respect of merger control of transactions. As is clear, these thresholds are many multiples higher than the current thresholds applied by the CMA in considering a market size too small to justify making a reference. While we note these thresholds are not *de minimis* thresholds as such, they reflect policy decisions taken in those countries as to the level below which they would be comfortable not to intervene in a merger control context, even in a merger of single-product duopolists.

2.7 In addition, we note that a *de minimis* market size threshold of €15 million (c.£13 million) applies in Germany where a market has been in existence for at least 5 years. This is almost three times higher than the CMA's proposed lower threshold of £5 million. Moreover, the German *de minimis* threshold removes the need for a notification, rather than creating discretion for the authority not to enter a Phase 2 review.

Other factors relevant to UK de minimis threshold

2.8 We understand that the CMA and its predecessor, the OFT, have applied the exception to the duty to refer in 26 of the 33 cases in which it has been considered (out of a total of some 600 cases reviewed) since 2010. The exception to the duty to refer is evidently a useful tool for the CMA. However, we would note that, given the conclusions drawn in these 26 cases, the markets involved were of insufficient importance to merit a reference, those 26 cases already represent considerable business and CMA resource invested in the Phase 1 process where the underlying market size was very small (in contrast to the operation of the German *de minimis* threshold which precludes a Phase 1 review).

2.9 There is a strong argument that the UK regime has the advantage over many other regimes of its voluntary nature, meaning only transactions raising genuine competition

[1] A lower combined French turnover threshold of €30 million applies in respect of transactions in the retail sector, with further lower thresholds applicable in respect of transactions affecting French overseas departments and communities.

questions need be notified. In this context there is also arguably greater resource for the CMA to consider transactions in smaller markets but which raise genuine competition concerns. We also recognise the argument that the level of the thresholds established in these other countries mean that potentially anticompetitive transactions in smaller markets escape scrutiny. However, a policy decision ultimately needs to be taken upon the appropriate minimum threshold for intervention, and our experience is that the existing thresholds impose a disproportionate burden on smaller transactions, and are considerably out of line with the levels in comparable economies.

2.10 We would also note that the CMA's acting Chief Executive is recently on record stating that he anticipates perhaps a 50% increase in merger caseload following Brexit with cases that currently fall under the EU Merger Regulation becoming subject to UK jurisdiction. It seems sensible to us that this Consultation should consider the impending significant increase in merger control workload which Brexit could trigger in order to establish thresholds which most sensibly allow the CMA to focus its resource on the larger cases which are likely to be those most capable of causing serious harm to UK consumers.

2.11 In this context, we note that the CMA has made increasing use of its Mergers Intelligence Committee (MIC) to filter out smaller and less obviously problematic cases – perhaps anticipating the application of the discretion not to refer in some of these cases. While this approach could be extended to manage resource constraints, it does not offer businesses certainty in advance as to whether transactions will be subject to review.

CLLS proposal

2.12 In the context of the above, the CLLS would like to suggest three specific changes to the CMA proposal:

(i) The CMA removes the current £10 million higher threshold for markets which it will generally not consider to be of sufficient importance to justify a reference.

In the CLLS's view, the operation of two thresholds creates business uncertainty and does not offer any material benefit to the CMA. We understand the vast majority of cases in which the discretion not to refer has been applied have related to markets which exceeded the £3 million threshold, but not the higher £10 million threshold. We also note that parties are still required to offer remedies to resolve any identified competition problems where these are clear cut and readily available, even where the market size falls below the current thresholds.

(ii) The CMA materially increases the current £3 million lower threshold for markets where the CMA will generally not consider a reference justified to at least £15 million.

In line with the approach of competition authorities in comparator economies, and noting in particular the *de minimis* market size threshold of €15 million applied in Germany, we believe a material increase in the current level at which businesses can expect the CMA to exercise its discretion is appropriate. An increase to £15 million, or higher, would send a clear message to business that the CMA intends to focus its resource on larger markets where competitive harm will be more significant. Businesses would in any event be constrained by the requirement to offer

remedies in cases where these are clear cut, even in respect of smaller markets.

(iii) The CMA commit to assessing application of the *de minimis* threshold in pre-notification, prior to commencing a Phase 1 review.

Currently, parties frequently find that the assessment of applicability of the discretion not to refer is only considered following much of the Phase 1 assessment (including potentially an Issues Meeting) – meaning parties to smaller transactions may already face considerable costs and delays prior to the CMA concluding that the markets concerned are too small to merit a reference. It would be beneficial to all concerned if this process could be reversed such that it is established before Phase 1 is initiated (or at least as a preliminary matter) whether the threshold to trigger a discretion not to refer based on market size is met, ahead of the more detailed Phase 1 assessment. Such a methodology would also result in a more efficient use of the CMA's own scarce resources at Phase 1.

Q.2 Do you agree with the potential benefits of these proposals?

2.13 The CLLS agrees that the increased market size thresholds proposed could lead to certain benefits, including a reduction of merger control on businesses. In 2010 the cost of a reference was cited as being in the region of £400,000. In the CLLS's view, the overall cost to the UK economy of a reference - including lost management time for companies, adviser costs, CMA costs, and business disruption – is likely to be materially higher than this. However, in light of the relatively low increase to these thresholds being proposed, any such benefits are likely to be marginal, and could be materially improved with a more meaningful increase in the level of these thresholds.

2.14 We appreciate that the CMA may be concerned that a significant increase in the level of these thresholds would lead to a higher number of potentially problematic mergers in smaller or local markets falling outside its purview. However, the commercial reality is that less significant markets will typically have lower barriers to entry (due to low sunk costs required to enter), and consumers will have relatively higher buyer power (given the relatively low value of the market, even if individual goods or services are relatively expensive). Moreover, as above, the burden of the review process on smaller companies needs to be considered alongside the importance for CMA to be able to best allocate its limited resources in a context where Brexit could mean a significant increase in its workload.

Q.3 Do you have any other comments about the proposed changes?

2.15 In conjunction with the increase to the market size thresholds, another aspect of the current regime which imposes material – and in the CLLS's view unnecessary – burdens on business and the CMA is the duty to refer where the prospect of an SLC finding is low. The CLLS urges the CMA to consider how to better manage its duty to refer mergers with less than a 50 percent likelihood of resulting in an SLC under its current *Merger Assessment Guidelines.*[2] The Enterprise Act 2002 provides for such a duty to refer where, in the CMA's judgement, a transaction "has" or "may be expected to" result in an SLC – the

[2] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 2.6.

"realistic prospect" standard. The Court of Appeal's judgment in *IBA Health*[3]is helpful in this respect in clarifying that the then-OFT had a duty to exercise its judgement when assessing whether a merger should be referred. The application of the *de minimis* exception shows that the CMA is well able to handle a nuanced approach to these questions, balancing factors which may be relevant to an assessment of the chance of an SLC beyond the *de minimis* analysis.

2.16 Consequently, the CLLS suggests that the CMA amend paragraph 2.6 of its *Merger Assessment Guidelines* as follows, to better reflect the Court of Appeal's ruling in *IBA Health*:

"*If the [CMA] believes that the relevant likelihood is greater than fanciful, but below 50 per cent, it has a wide margin of appreciation in exercising its judgement. In such cases, it has a duty to refer when it believes there to be a realistic prospect that the merger will result in an SLC. However, the CMA will exercise its judgement and discretion in concluding that a transaction may be expected to result in an SLC where the likelihood of an SLC is below 50 per cent.*"[4]

2.17 The alternative remedy in this context would be for amendments to be made to the primary legislation (ss. 22 and 33 of the Enterprise Act 2002) to make clear that the CMA has a *discretion*, and not a *duty*, to make a reference in cases where the likelihood an SLC is relatively low (more than fanciful but below 50 per cent). However, the CLLS recognises this may not be an immediate possibility and believes the suggestion above would give the CMA better flexibility to manage low risk cases which exceed the *de minimis* thresholds without being required to make a reference.

CLLS Competition Law Committee

13th February 2017

[3] *Office of Fair Trading and others v IBA Health Limited* [2004] EWCA Civ 142, judgment of 19 February 2004.

[4] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, paragraph 2.6.