Slaughter and May response to CMA Consultation: Guidance on Initial Enforcement Orders and Derogations in Merger Investigations

1. Overview

1.1 We welcome the CMA's decision to issue guidance on Initial Enforcement Orders (**IEOs**) and derogations in merger investigations. This is an area in which the previous guidance was limited and the guidance will help to facilitate understanding about the CMA's policy and practice in this area.

1.2 The policy objective of the IEO tool is to ensure, given the voluntary nature of the UK merger regime, that steps are not taken by the parties to a merger that would hamper the CMA's ability to prohibit a merger or impose conditions to clearance if it later finds that the merger would result in a substantial lessening of competition (**SLC**). In practice, as noted in paragraph 2.6 of the consultation document, the CMA has adopted a policy of imposing an IEO in completed merger cases unless it has compelling evidence that there is no risk of pre-emptive action or there are self-evidently no competition concerns. This is a high benchmark for avoiding an IEO. As the CMA notes in paragraph 2.6, this policy means that the CMA normally expects to impose IEOs in completed merger cases.

1.3 Whilst we understand the reasoning behind the CMA's approach to the imposition of IEOs in completed merger cases, the standard wording of the IEO used by the CMA does not fit all transactions and is disproportionate in some cases. The CMA should bear in mind that the imposition of an IEO is a serious step that may result in unnecessary costs as well as prevent the parties from benefiting from synergies and more generally from running the business acquired as they see fit. The UK merger regime is a voluntary notification regime and parties should not be penalised simply because they have decided to complete a merger in advance of obtaining CMA clearance, which they are fully entitled to do. In these circumstances, we consider that the CMA ought to take a proportionate approach involving:

(A) the removal of the IEO as soon as possible if it becomes clear that the merger will not result in an SLC; and

(B) the granting of derogations requested by the parties unless the CMA has reasonable grounds for suspecting that the requested derogation would materially risk the CMA's ability to take action later if the merger is found to result in an SLC.

1.4 By way of illustration of this issue, the standard form IEO prevents integration of the businesses worldwide. For global transactions, where the UK part of the transaction may be extremely small, this is disproportionate and we consider that a derogation allowing integration outside of the UK should be provided at the same time the IEO is imposed unless the CMA has compelling reasons for why such a derogation should not be granted in a particular case (i.e. the CMA has reasonable grounds for suspecting that integration outside the UK would materially risk the CMA's ability to take action later if the merger is found to result in an SLC in the UK). This will be particularly important in a post-Brexit world where more global transactions may need to be notified separately in the UK. It is

also important given that the UK merger control time periods are relatively lengthy by international standards, meaning that the UK merger approval may be obtained later than merger clearance in other key jurisdictions worldwide.

1.5 We consider that the CMA's suggestion at paragraph 3.3 of the draft guidance that the CMA will take a cautious approach to granting derogations and only grant narrow derogations, particularly at Phase 1, is disproportionate. A cautious approach should only be justified where the CMA has reasonable grounds to suspect that the proposed derogation would materially risk the CMA's ability to take action later if the merger is found to result in an SLC. A cautious approach would not be justified, for example, if the CMA is unable to articulate clearly why the proposed derogation would hamper its ability to take action later.

1.6 In considering the imposition of IEOs, it is also important to bear in mind that the UK merger notification regime is voluntary and so companies are free to complete mergers without notification to the CMA. The CMA should take care to avoid using the IEO regime to bring in mandatory prior notification through the back door by preventing companies from taking any integration steps until the IEO is lifted. The CMA's proposed approach risks operating in practice as a ban on any integration during the CMA's Phase 1 investigation. To businesses, this looks like a mandatory prior notification regime, which is not the legislative framework under which the CMA operates. We assume that this is not the CMA's intention and so the draft guidance should be changed to clarify that derogations will be issued unless the CMA has reasonable grounds to suspect that the proposed derogation would materially risk the CMA's ability to take action later if the merger is found to result in an SLC.

1.7 We are pleased that the CMA has taken on board some of the comments we raised at our meeting with the CMA in February 2016, for example our request for more guidance to aid self-assessment of compliance with IEOs. However, there are some areas where the draft guidance could provide further clarification. In this section we have set out the key principles we consider the CMA should keep in mind when considering IEOs and derogations which should be reflected in the final guidance. We provide responses to the specific questions in the consultation document below.

2. 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?

Dedicated derogations experts

2.1 We note that the CMA has in recent cases included additional team members to advise on derogations, including a member of the Remedies Team. If this is now the CMA's practice, we suggest that this is covered in the guidance. In order to enable the case team to focus on reviewing the substance of the merger, it makes sense for the CMA to involve additional staff with suitable expertise to review proposed derogations in parallel. This reduces the risk that the case team's substantive review of the merger is delayed as a result of protracted negotiations on derogations. A staff member with expertise in

derogations may also be able to assess more quickly whether a requested derogation is likely to affect the CMA's ability to take remedial action. To this end, we would support the use by the CMA of dedicated derogations experts, who are able to deal with derogation requests quickly and efficiently bearing in mind the principles set out in section 1 above.

2.2 It is important that the CMA co-operates with parties that approach the CMA early to discuss derogations. The majority of parties engaging with the CMA on derogations before an IEO is imposed are likely to have the objective of finding a proportionate solution that works to address the CMA's concerns, whilst enabling them to take steps that would not impact the CMA's ability to take remedial action later. A constructive dialogue with the case team and dedicated derogations experts is important to find a solution that works for the CMA and the businesses concerned and is proportionate. The CMA should be prepared to explain to the parties why they have concerns about any specific derogations requested so that the parties can have the opportunity to present other options that may work for the CMA and the parties.

Template derogation request

2.3 Whilst the draft guidance provides some clarification on the derogations that are likely to be granted by the CMA "where sufficiently specified, reasoned and evidenced", it remains unclear what form the CMA would like derogation requests to take. The information published on the CMA's website does not provide any detailed examples of the form that derogation proposals should take. In our experience, the CMA has required several submissions on each derogation following additional requests for information from the CMA. This process is not efficient for either side.

2.4 It would be much simpler to submit derogation requests that are sufficiently specified, reasoned and evidenced if the CMA provided a template derogation request.

2.5 The template could, as a minimum, cover derogations that the CMA has indicated are likely to be granted in paragraph 3.6 of the draft guidance, which could be used as guidance on the type of information and format that should be followed for other types of derogations. This would ensure that all the required information is provided at once and therefore reduce the time the CMA needs to review derogation requests.

Warning before sending IEO

2.6 When the CMA sends an IEO using the Egress encrypted email system, there is a risk that there will be a time lag between the legal advisers receiving the IEO and forwarding the IEO on to the parties. Attachments sent using Egress cannot be easily accessed or forwarded from a mobile device, requiring the legal adviser to be at a computer to retrieve and download the relevant documents. This can be problematic given that, as the CMA confirms in paragraph 2.10 of the draft guidance, the IEO takes effect as soon as it is sent to the legal advisers.

2.7 To mitigate this risk, if the CMA plans to send the IEO via the Egress system the CMA should warn legal advisers a minimum of one hour before the IEO is sent, so that the legal advisers are ready to forward on the IEO once received.

2.8 Alternatively, the CMA could send the IEO to legal advisers by regular email. In a recent case, we note that the case team did not use the Egress system to send out an IEO. We would recommend that the CMA pursue this approach in future, since sending the IEO via regular email is a simpler and more practical approach.

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

Integration outside the UK

3.1 As mentioned in paragraph 1.4 above, we consider that the CMA should grant a derogation for integration outside the UK immediately upon imposition of the IEO, unless the CMA presents compelling reasons why such a derogation should not be granted in a particular case. We consider that the 'compelling reason' would be that the CMA has reasonable grounds for suspecting that integration outside the UK would materially risk the CMA's ability to take action later if the merger is found to result in an SLC in the UK. This will be particularly important in a post-Brexit world where more global transactions may need to be notified separately in the UK. It is also important given that the UK merger control time periods are relatively lengthy by international standards, meaning that the UK merger approval may be obtained later than merger clearance in other key jurisdictions worldwide.

3.2 In any event, it is by no means clear that the Enterprise Act 2002 confers powers on the CMA to halt integration outside the UK, and the CMA should not be exercising extra-territorial powers.

3.3 Paragraph 3.24 to 3.26 of the CMA's proposed guidance is helpful but does not go far enough. The CMA should include text to make it clear that derogations will be granted for integration outside the UK unless the CMA has reasonable grounds for suspecting that integration outside the UK would materially risk the CMA's ability to take action later if the merger is found to result in an SLC in the UK. This will make it clearer to parties to global transactions, particularly those where the UK business makes up only a small fraction of the overall worldwide business, that the CMA is aiming to act reasonably and proportionately.

Financial reporting

3.4 In our experience, the CMA has interpreted the type of financial information that is permitted to be shared in accordance with the terms of the template IEO (i.e. on the basis that it is "strictly necessary") narrowly, with the CMA reading this as financial information required for the purpose of preparing statutory accounts. Most (if not all) businesses have management accounting requirements for internal financial management purposes which the CMA may regard as not being permitted under the standard form IEO. It would clearly

be disproportionate not to allow businesses to have access to financial data on a business that they own subject to appropriate protections being put in place to ensure that the CMA's ability to take remedial action later if required is not prejudiced. The current wording of the guidance gives the impression that it may be difficult to obtain a derogation for such information flows. We assume that the CMA has not meant to give such an impression, but is trying to highlight that certain protections will need to be put in place in terms of who can access the information, the level of detail, etc. We suggest that the CMA makes a general comment that it should be possible to grant a derogation for internal financial reporting, provided that certain protections are put in place to ensure that specific UK business data is not seen by people outside a clean team so as not to hamper the CMA's ability to take remedial action later if required. It would be particularly helpful for the CMA to provide a template for such a derogation request, given that we would expect this derogation will likely be required in most cases.

4. 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?

Consolidated derogation requests

4.1 We agree with the CMA that in general it is desirable for various derogation requests to be consolidated into one derogations proposal. However, this should not mean that in practice no derogations will be approved until the finer details of all derogations are finalised. This approach can result in the approval of straightforward derogations being unnecessarily delayed, when (in accordance with the principles above) such derogations should be approved very quickly.

4.2 This is especially problematic in the context of asset sales, as derogations may be essential immediately after the IEO is imposed (assuming the IEO is imposed very shortly after closing), to ensure that the target remains a viable standalone business.

4.3 The guidance in paragraph 2.10, indicating that the CMA will publish derogations simultaneously with the IEO only where the parties have demonstrated that provisions of the template IEO are not relevant, is too narrow. Where parties have demonstrated that certain derogation requests are time-critical and they are ready to be published at the same time as the IEO, the CMA ought to be flexible enough to accommodate those derogations, even when such requests are not based on an entire section of the template being irrelevant. For example, we can foresee a situation where the CMA could grant a derogation allowing integration outside the UK immediately on issue of the IEO, with more complex derogations following later.

Compliance statements

4.4 The CMA should give examples of persons that the CMA will typically accept as suitable to sign compliance statements in lieu of the CEO. For example, the CMA could expand the guidance to state that any member of the board of directors (or senior manager with authority to bind the company) is likely to be accepted as suitable absent any exceptional circumstances.

5. 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?

CMA informal approval of self-assessment

5.1 In line with the principle that the CMA's filing regime is voluntary, we expect the CMA generally to accept the self-assessment by parties and their legal advisers that a contemplated action does not require a derogation.

5.2 However, it would be useful for the guidance to include an indication of whether the CMA expects to discuss the self-assessment made by the parties in relation to contemplated actions if the parties conclude that a derogation is not required. For example, where the parties conclude that they do not need a derogation relating to the exchange of financial information, do the parties still need to discuss with the CMA (without making a formal derogation application) the nature of financial information that will be shared, before the information is exchanged?

6. Contact details

6.1 If you would like to discuss this submission, please feel free to contact:

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