



Competition and Markets Authority Consultation
Draft revised CMA guidance on jurisdiction and procedure in mergers

Response of Herbert Smith Freehills LLP

Herbert Smith Freehills LLP welcomes the opportunity to comment on the CMA's draft revised guidance on jurisdiction and procedure in mergers ("**Revised Guidance**") which reflects the impact of Brexit on the UK merger control regime, the CMA's decisional practice and court decisions, and the publication of new or updated guidance on various aspects of the UK merger control regime. Clear and up to date guidance which reflects the CMA's latest practice will assist merging parties and should enhance the transparency of the process.

The majority of our comments relate to Chapter 4 on jurisdiction and relevant merger situations, and in particular the updates to the text on the share of supply test and material influence. We have also picked up on a range of other points throughout the Revised Guidance, and our comments are set out in the order these appear in the text.

The comments set out in this response are those of Herbert Smith Freehills LLP and do not necessarily represent the views of any of our individual clients.

1. Chapter 4: Jurisdiction and relevant merger situations

1.1 Our comments on Chapter 4 of the Revised Guidance focus on an area in relation to which the CMA has recently applied its discretion in a manner which we consider to be *ultra vires* - namely the share of supply test. We also have comments on other sections of this chapter, most notably material influence. However, given the importance of the share of supply test to the remit of UK merger control, and the fact that the CMA's recent practice has stretched this concept well beyond its elastic limit, we consider that this should be the focus of the CMA's review of Chapter 4 of the Revised Guidance.

1.2 In particular, we note that the CMA has of late employed a highly expansionist interpretation of the share of supply test, and that one example of this expansionist interpretation is currently subject to appeal in *Sabre v CMA*.¹ Given that the case is still *sub judice* at the time of submission, we suggest that, should the appeal be upheld partially or in full, the Revised Guidance would likely have to be amended to reflect any relevant judicial interpretation, and a revised consultation should be held on this point. We would be happy to comment on any revised text.

1.3 We further note that the Revised Guidance treats as binding precedent some of the CMA's own decisions. We would caution against an over-reliance on decisional practice, in particular where

¹ *Sabre Corporation v Competition and Markets Authority*, Case no 1345/4/12/20



similar fact patterns have been overturned on appeal or to the subject of judicial criticism. For instance, in the event that the *Sabre/Farelogix* decision² is subject to a successful appeal, the similar fact pattern in *Roche/Spark*³ (i.e. that jurisdiction was asserted despite the fact that the target achieved no UK turnover) should not be treated as a binding precedent, akin to a judicial decision, for future cases. By contrast, where the courts have specifically upheld the CMA's decisional practice, this can be stated as effectively binding on parties.

- 1.4 We also note that the amendments set out at paragraphs 4.3 et seq of the Revised Guidance relating to national security will likely soon become redundant if and when the National Securities and Investment Bill (“**NSI Bill**”) is passed – anticipated in early 2021. We suggest that it may therefore be sensible to issue a further draft of the Revised Guidance which takes into account any judicial directions emanating from the *Sabre* appeal and the passing into law of the NSI Bill.

The share of supply test

- 1.5 We do not agree with the principal revisions to the description of the share of supply test, namely the expansion of the CMA's ability to find that this test is satisfied as a result of: (i) a description of goods or services which is based on the “*commercial reality*” of the merger parties' activities, (ii) a sufficient UK nexus arising from non-contractual relationships between the merger parties, and (iii) the 25% threshold being met on a wide and open range of metrics.
- 1.6 Before we consider each of these, we note that although the Enterprise Act 2002 (“**EA 2002**”) confers on the CMA broad discretion in determining whether, for the purposes of the share of supply test, the relevant goods or services are of the same description and the 25% threshold is met, this discretion is not without limit and its use must be “*appropriate*.”⁴ Whether or not this discretion is exercised appropriately should be informed by the Parliamentary debates which preceded the enactment of the EA 2002, which placed significant emphasis on the fact that the jurisdictional thresholds, including the share of supply test, should be “*straightforward*” and “*simple and easy to determine quickly*” to promote certainty and alleviate the burden on businesses.⁵ The importance of clarity and simplicity in merger notification thresholds has also been highlighted by the International Competition Network.⁶ This is not surprising given the

² CMA Decision on relevant merger situation and substantial lessening of competition ME/6806/19

³ CMA Phase 1 Decision ME/6831/19, Anticipated acquisition by Roche Holdings, Inc. of Spark Therapeutics, Inc., 10 February 2020

⁴ Sections 23(5), 23(6) and 23(8), EA 2002.

⁵ See remarks of Lord Sainsbury of Turville during House of Lords debate: Hansard, HL vol. 639, col.794 (15 October 2002) and of Miss Johnson (under-Secretary of State for Trade and Industry) during House of Commons Standing Committee B: Hansard, HC Standing Committee col.328 (30 April 2002).

⁶ See the International Competition Network's Recommended Practices for Merger Notification and Review Procedures (May 2017), one of the key principles of which is that “*notification thresholds should be clear and understandable*.” The International Competition Network explains that “*clarity and simplicity are essential features of well-functioning notification thresholds*. Given the increasing number of multi-jurisdictional transactions and the growing number of jurisdictions with merger notification requirements, the business



burdens associated with merger review processes, including the fact that they can lead to extensive remedies or even deal failure (i.e. prohibition or abandonment). In these circumstances, certainty over which transactions will be subject to review and where is key.

1.7 The UK's share of supply test is already one of the most flexible jurisdictional thresholds in the world and we are concerned that the CMA's proposed changes will only serve to make its application more uncertain. This is all the more worrying when considered alongside the fact that the CMA's increasing use of initial enforcement orders has made the UK merger control regime mandatory in all but name.

1.8 Taking each of the principal revisions in turn:

1.8.1 In discussing how the CMA may find a reasonable description of goods or services, the Revised Guidance now states that this "may" – rather than will "often" – correspond with a standard recognised by the industry in question.⁷ The Revised Guidance goes on to state that: "*The CMA will consider the commercial reality of the merger parties' activities when assessing how goods or services are supplied, focussing on the substance rather than the legal form of arrangements. Firms can engage in a variety of different business models and the way in which firms interact (with each other and other market participants) to win business over time can vary significantly. In practice, this means that competitive interactions between firms may not be reduced to overlaps in directly-marketed products or services but can result, for example, from overlaps involving pipeline products or services, or where there are sufficient elements of common functionality between the merger parties' activities, amongst other factors.*" This is very vague and the examples provided simply raise more questions: what will the CMA consider to be a "pipeline" product or service (in particular as there is only one pharma-related CMA decision cited in support). How many elements of common functionality between the merger parties' activities are "sufficient" to find that they fall within the same description of goods or services? Presumably this requires supply to the same customers or acquisition from the same suppliers, given that the test requires some form of horizontal overlap?⁸ What are the "other factors" the CMA will consider? Without more precision on these issues – and given the move away from relying on industry standards – there is significant scope for uncertainty for businesses and their advisers.

community, competition authorities, and the efficient operation of capital markets are best served by clear, understandable, and easily administrable "bright-line" tests."

⁷ See paragraph 4.63, Revised Guidance, compared with paragraph 4.65, CMA2 Mergers: Guidance on the CMA's jurisdiction and procedure (January 2014) ("**Current Guidance**").

⁸ Sections 23(2A), (3), (4), (4A) and (4B), EA 2002. In addition, as paragraph 4.63(d), Revised Guidance and paragraph 4.56, Current Guidance make clear, the share of supply test cannot capture purely vertical mergers.



- 1.8.2 In discussing how the CMA may determine whether the relevant goods or services are supplied in the UK or a substantial part of it, the Revised Guidance states that: *“The CMA will also have regard to the nature of the relationships between the merger parties and their customers (including as between different customer groups). While the CMA will consider direct contractual relationships, it may also consider customer relationships that are not governed by contract, as well as other relevant factors. For example, under section 128 of the Act, the supply of services includes the provision of services by making them available to potential users, and making arrangements for the use of computer software.”*⁹ This is also very vague: what types of “customer relationships that are not governed by contract” does the CMA have in mind? What are the “other relevant factors”? While it is true that section 128 EA 2002 provides examples of what constitutes the supply of services, these are much more specific than the proposed text and leave far less room for questions.¹⁰ The intention was no doubt to provide clarity and promote certainty. The open-ended nature of the proposed amendments cuts against this: the CMA should either be more precise or, if that is not possible, drop these proposed additions.
- 1.8.3 Although it is helpful that the Revised Guidance now contains a separate section on the 25% threshold, as currently drafted, this simply re-iterates the relevant provisions of the EA 2002 which are themselves very vague. For example, the fact that the CMA may have regard to the “*value, cost, price, quantity, capacity, number of workers employed, or some other criterion, of whatever nature, or such combination of criteria, as the [CMA] considers appropriate*” in determining whether the 25% threshold is met,¹¹ does not provide businesses with sufficient certainty over the metrics the CMA will use to calculate the 25% threshold in any given case. As footnotes 102 and 103 of the Revised Guidance show, the use of non-value/volume based metrics (which are typically used to calculate market shares for both jurisdictional and substantive purposes in most merger control regimes, including, historically, in the UK) is relatively recent, untested by the courts, and highly fact-specific (e.g. number of workers employed or patents procured in *Roche/Spark*, number of bidders in

⁹ Paragraph 4.64(c), Revised Guidance.

¹⁰ As well as including the provision of services by making them available to potential users and making arrangements for the use of computer software, section 128 provides that the supply of services includes performing for gain or reward any activity other than the supply of goods, rendering services to order, granting access to data stored in any form which is not readily accessible, making arrangements by means of a relevant agreement (within the meaning of paragraph 17 of Schedule 3A of the Communications Act 2003) for sharing the use of electronic communications apparatus, and permitting or making arrangements to permit the use of land in such circumstances as the Secretary of State may by order specify. Conversely, the supply of services does not include the provision of services under a contract of service or apprenticeship.

¹¹ Section 23(5), EA 2002.



*Mastercard/Nets*¹²). If the CMA intends to use such metrics going forwards, it should be clear about the circumstances in which it will use them over traditional value/volume-based metrics and be more precise about the “*other*” criteria it may consider appropriate in any given transaction.

- 1.9 In sum, we are concerned that the proposed revisions to the description of the share of supply test will only perpetuate uncertainty at a time when certainty in the application of the UK merger regime is crucial: with Brexit and the end of the “one-stop-shop” historically provided by the EU merger control regime fast approaching, now more than ever is it important for businesses to have certainty over whether their transactions will be subject to CMA review. With that in mind, and given that the limits of the CMA’s discretion to apply the share of supply test are currently being considered by the Competition Appeal Tribunal in *Sabre v CMA*, we urge the CMA to reconsider rushing through these changes and take the time it needs to work through their implications, seeking input from all relevant stakeholders (including businesses and Parliament) along the way.

Material influence

Use of decisional practice

- 1.10 At the outset we note that, as per the CMA Consultation Document on the Draft Revised Guidance on the CMA’s Jurisdiction and Procedure in relation to Mergers (“**CMA2con and CMA56con**”), the CMA has “[*updated*] the text on the ability to exercise material influence to reflect developments in the CMA’s decisional practice since the adoption of the Current Guidance.” This is reflected in the fact that the Revised Guidance draws principally from the CMA’s recent decisions in *Amazon/Deliveroo* and *RWE/E.On*.¹³ While updating the Current Guidance to take account of these recent decisions is welcome, as set out in the Introduction above, we caution against an over-reliance on such recent decisional practice which was generally considered to be controversial, despite not having been subject to an appeal.

Shareholdings of less than 15%

- 1.11 Paragraph 4.20 of the Current Guidance states that “*exceptionally, a shareholding of less than 15% might attract scrutiny.*” We note, however, that this has been re-framed in the Revised Guidance as follows: “[*e*]ven shareholdings of less than 15% may attract scrutiny.”
- 1.12 This change implies that the CMA no longer considers such a scenario to be “*exceptional*”. However, this is not supported by the CMA’s decisional practice in the period since the

¹² CMA Request pursuant to Article 22 of Council Regulation (EC) 139/2004 ME/50824-19, Anticipated acquisition by Mastercard Incorporated of Parts of the Corporate Services Business of Nets A/S, 3 April 2020.

¹³ CMA Final Report: Anticipated acquisition by Amazon of a minority shareholding and certain rights in Deliveroo (4 August 2020); CMA Decision: Anticipated acquisition by RWE AG of a 16.67% minority stake in E.On SE (5 April 2019).



publication of the Current Guidance: to the best of our knowledge, the CMA has not found material influence at a shareholding of less than 15% since 2014, and has only very exceptionally done so before then. Therefore, we would be grateful if the CMA could clarify in the Revised Guidance whether it no longer considers a finding of material influence at less than 15% to be “*exceptional*”. If this is the case, it would, in our view, represent an unwelcome change in decisional practice and so further specific detailed guidance on the circumstances in which such material influence could be found would be merited (going beyond the general reference to relevant factors in the Revised Guidance). This would help reduce legal uncertainty for minority investors in the UK: otherwise, lack of clarity over the level of shareholding at which the CMA’s jurisdiction could be triggered could have a chilling effect on such investment, particularly in the technology sector where rounds of minority venture capital financial investments are common. Such a policy by the CMA would also be highly exceptional when compared to other global merger control regimes where relevant triggering thresholds tend to be set at much higher shareholdings.

Special voting or veto rights over relevant policy or strategic matters

- 1.13 Paragraph 4.21 of the Current Guidance notes that “*other factors relevant to an assessment of a particular shareholding may include... the existence of any special voting or veto rights attached to the shareholding under consideration.*” This has been re-worded in the Revised Guidance as follows: “*an acquirer’s shareholding... may still in some cases afford the acquirer special voting or veto rights over relevant policy or strategic matters sufficient to confer material influence.*”
- 1.14 As the CMA will be aware, it is common practice for minority venture capital investment to take place via funding rounds, creating tiered rights for different “series” of shareholders depending on, *inter alia*, the timing and amount of their investment. The very existence of these tiers means that certain shareholders will have superior or “special” rights when compared to others. However, we consider that the mere fact that one shareholder holds superior rights should not be treated as a source of material influence for that shareholder without a detailed examination of the relevant right and its purpose.
- 1.15 Therefore, we consider that the Revised Guidance should make clear that standard practice minority shareholder protections which relate purely to protecting the value of an investment would not fall within the scope of such “*special voting or veto rights over relevant policy or strategic matters.*” In particular, we consider that superior rights relating to liquidation preference do not typically confer on the holder the ability to “*materially influence policy relevant to the behaviour of the target entity in the marketplace*” (the terminology used at para. 4.2 of the Revised Guidance) – indeed, such rights would only be relevant after that target has exited



that marketplace.¹⁴ As a result, specific examples of the types of “*special voting or veto rights over relevant policy or strategic matters*” which the CMA would typically expect to confer (or not confer) material influence would be very welcome in the Revised Guidance.

2. Chapter 6: Notification of mergers to the CMA

- 2.1 Paragraph 6.2: the removal of the statement that “*the fact that a merger has not been notified does not negatively affect the CMA’s substantive evaluation of the competitive effects of a merger*” is unfortunate and seems to imply that there is scope for the parties to be penalised if they choose not to notify.
- 2.2 Combined with the addition to paragraph 6.1 that “*there can be significant benefits to merger parties notifying a merger to the CMA and/or engaging in early discussions with the CMA as to whether they should notify a merger*” and footnote 109 (which notes that “*a number of cases referred by the CMA for a phase 2 investigation have been ones which the merger parties did not voluntarily notify...*” and provides examples), this seems to play down the voluntary nature of the UK merger control regime. It is important for the Revised Guidance to be clear that parties are at liberty to choose not to notify and that they will not be penalised, directly or indirectly, for making this entirely lawful choice.
- 2.3 Paragraph 6.9: the informal advice procedure has been removed from the Revised Guidance on the apparent basis that it is rarely used and it is always open for the merging parties to contact the CMA to discuss any aspect of merger control. The two options now listed for parties to discuss a transaction with the CMA are to submit a request for a case team or to submit a briefing paper to the Mergers Intelligence Unit. We consider that the informal advice procedure can be beneficial. Briefing papers are intended to seek guidance on whether there is a relevant merger situation or to explain why there is no SLC. Informal advice could in theory address a range of novel issues which are not necessarily limited to these topics and it would be helpful for the Revised Guidance to include a short paragraph explaining that parties can contact the CMA to discuss any aspect of merger control and how they should do so, as well as setting out the expected timeframes for response.
- 2.4 Paragraph 6.15: the CMA has standard questionnaires to seek information in completed mergers in order to ascertain the degree of integration. It would be helpful to attach these to the Revised Guidance.
- 2.5 Paragraph 6.17: there should be an express acknowledgement that the CMA will not issue an invitation to comment during pre-notification in relation to deals that are not yet public.

¹⁴ Although it is not possible to reconstruct the exact fact-pattern due to redactions, it appears that the CMA may have taken a contrary approach to such liquidation rights at paragraph 4.29 of CMA Final Report: Anticipated acquisition by Amazon of a minority shareholding and certain rights in Deliveroo (4 August 2020).



- 2.6 Paragraph 6.68-6.70: reference to the EU Commission's guidance on ancillary restraints is removed and replaced with a new annex C on ancillary restraints. As the text in the annex replicates the EU Commission's guidance (with minor adjustments) it would be useful to make this clear upfront, as this means that it should be interpreted in light of the EU Commission's practice. It will be important for the merging parties and their advisers to be aware of this.
3. **Chapter 7: Fast track processes and conceding an SLC**
- 3.1 Paragraph 7.5: the anticipated merger between Crowdcube Limited and Seedrs Limited which was fast-tracked to phase 2 on 12 November 2020 could be added to footnote 130.
4. **Chapter 9: The phase 1 assessment process**
- 4.1 Paragraph 9.29 and 9.32: much around the contents of an issues letter has been removed and does not seem to be replicated elsewhere. This is the same for paragraph 9.32 and 9.33 and any reference to the case review meeting procedure. It would be helpful if the CMA could clarify whether this reflects a change in its approach. These are important procedural steps in relation to which guidance on the CMA's approach is necessary.
5. **Chapter 10: Phase 2 inquiries – overview**
- 5.1 Paragraph 10.10: it is stated that stages of the phase 2 process may be omitted. This should only happen at the initiative of the parties and this should be made very clear.
- 5.2 Footnote 167: merging parties may decide that a "main party hearing" is unnecessary where the CMA's emerging thinking is such that the merger may not be expected to result in an SLC. This also gives rise to concern in light of the number of cases in which the CMA has recently amended or supplemented its provisional findings given changes very late in the process (e.g. *Amazon/Deliveroo*; *Bauer Media*¹⁵). This risk should be set out more clearly. Also, what would be the impact on procedural fairness if parties decide to forgo the main hearing and the CMA subsequently changes its approach as set out in its provisional findings?
6. **Chapter 11: Phase 2 inquiries – key stages prior to provisional findings**
- 6.1 Paragraph 11.13: this now recommends that parties limit the number of submissions outside the key stages of the inquiry. However, if new information becomes available to one of the parties, or there is an unforeseen variable they need to contend with (e.g. Covid-19), parties should not be deterred from making unscheduled submissions. The threshold for submissions to be excluded or rejected should be set at a high level and the fact that this is the case should be made very clear in the Revised Guidance.

Herbert Smith Freehills LLP

3 December 2020

¹⁵ CMA Final Report Completed acquisitions by Bauer Media Group of certain businesses of Celador Entertainment Limited, Lincs FM Group Limited, Wireless Group Limited, and the entire business of UKRD Group Limited (12 March 2020)