Linklaters

Energy Network Mergers: Draft Guidance on the CMA's Procedure and Assessment

Linklaters' Response dated 24 January 2024

1 Introduction

(1) We are pleased to respond to the Competition and Markets Authority's (the "**CMA**") consultation on the draft guidance on the CMA's procedure and assessment in relation to energy network mergers ("**Draft Guidance**") under the Energy Act 2023 ("**EA23**").

(2) We welcome the CMA's willingness to engage with practitioners and other stakeholders on the UK energy network merger regime.

(3) The Draft Guidance provides a helpful tool for practitioners and stakeholders to better understand and advise on the complexities of the UK energy network merger regime.

(4) As set out in this response, the Draft Guidance would benefit from some alternative approaches and clarifications in respect of its practical operation. These would avoid undue uncertainty and/or administrative burden, with regard to both the merging parties and to the regulators. We consider that such changes, if incorporated into the Draft Guidance and appropriately implemented, will improve the energy network merger regime to the benefit of all stakeholders.

(5) In this response, we comment in particular on:

(i) the role and weight of Ofgem's opinion;

(ii) the approach to information requests and information exchange between the CMA and Ofgem;

(iii) the process for parallel merger reviews; and

(iv) other procedural considerations with regard to undertakings in lieu ("**UILs**"), relevant customer benefits ("**RCBs**") and remedies.

(6) Paragraph numbers cited in this response refer to paragraphs in the Draft Guidance, unless indicated otherwise.

2 Role and weight of Ofgem's opinion

(7) The EA23 makes clear that the CMA "*must ask*" and "*must consider*" Ofwat's opinion.[1] Paragraph 2.4 of the Draft Guidance notes that the CMA "*must consider*" Ofgem's opinion on "*both the likely prejudice, and extent of such prejudice, and whether such prejudice is outweighed by RCBs*". However, the weight accorded to Ofgem's opinion appears to vary at different stages of the process. Paragraphs 4.17 and 5.9 state that, in deciding whether to refer the merger to Phase 2, the CMA will place "*significant weight*" on Ofgem's opinion on whether (i) the merger is likely to prejudice Ofgem's ability in carrying out its comparative functions and (ii) any prejudice identified is outweighed by any RCBs related to the merger. At the UILs stage, the standard is, again, referred to as a duty to "*consider*" Ofgem's opinion on the effectiveness of the UILs offered (Paragraph 6.18). Given the differences in terminology, we would welcome additional clarity on the standard adopted with regard to Ofgem's opinion at each stage of the process. It would also be helpful to understand what "*significant weight*" (emphasis added) and the CMA's duty to "*consider*" will entail, as well as

[1] EA23, Schedule 16, Part 1, Paragraph 2 (Section 68D(1)).

any additional guidance on the evidence that merging parties would be expected to put forward to enable the CMA to depart from Ofgem's opinion.

(8) In addition, we would recommend that the CMA provides greater clarity on the discrepancy between the CMA's and Ofgem's standard of assessment at Phase 1. We note from Paragraph 1.10 that Ofgem's opinion will address "*whether and to what extent the creation of the relevant merger situation has prejudiced, or may be expected to prejudice*" Ofgem's ability to carry out its comparative functions.[2] Meanwhile, the CMA will only refer the merger to a Phase 2 investigation where it believes that the merger has caused, or may be expected to cause, "*substantial prejudice*" (emphasis added, Paragraph 2.2). We note that the CMA's threshold here differs from the existing framework for the special water merger regime under the Water Industry Act 1991 and we invite the CMA to provide further guidance on the extent of prejudice that it would consider "substantial".[3] Moreover, it would be helpful to understand what types of metrics the CMA intends to adopt in measuring such prejudice, i.e. whether it would adopt Ofgem's or rely on its own metrics/assessment.

(9) We would also welcome further clarification on Ofgem's role in Phase 2. Paragraph 1.8 states that "*Ofgem does not have an express statutory role in a CMA phase 2 investigation*", although it goes on to note that the CMA will continue to engage with Ofgem throughout Phase 2 and that "*Ofgem's views and submissions will play an important role in those investigations*". We note in particular that, when considering Ofgem's opinion from Phase 1 in a Phase 2 context, the CMA should be mindful of the fact that Ofgem's opinion (including its assessment of RCBs) is linked in substance to the Phase 1 standard of review – especially given that the purpose of Ofgem's assessment is to inform the CMA's decision on whether to refer the merger for a more detailed investigation.[4] We would therefore encourage the CMA to exercise extreme caution in relying on Ofgem's opinion at Phase 2, as it is designed primarily for Phase 1 purposes. To the extent that the CMA relies on opinions or assessments undertaken by Ofgem, merging parties should be provided access to any analysis and data underpinning these. This would enable the merging parties' own external experts to test the conclusions, conduct parallel cross-checks and undertake alternative assessments. Should there be confidentiality concerns, the CMA could limit disclosure to a selected and ring-fenced group of external advisers acting for the merging parties. The merging parties' ability to properly present and defend their case would be materially hindered otherwise.

3 Approach to information requests and information exchange between the CMA and Ofgem

(10) We note the CMA's guidance concerning information requests and the importance of complying with such requests. We welcome the proposed approach whereby the CMA and Ofgem, where appropriate, will coordinate information requests to minimise the burden on the merging parties.

(11) We further encourage the Draft Guidance to incorporate best practices developed for the "standard" merger regime under the Enterprise Act 2002 ("**EA02**"). For example, issuing

[2] See also paragraphs 3.3 to 3.8 of Ofgem's "*Approach to energy network mergers and statement of methods*" ("**Statement of Methods**"), currently also out for consultation, which states that Ofgem's assessment will involve both quantitative (monetary) and qualitative elements.

[3] Under the special water merger regime, the CMA will refer a merger for a Phase 2 investigation where it has caused or is likely to cause "prejudice" to Ofwat's "ability to make comparisons between water enterprises" – see sections 32 and 33A(b) of the Water Industry Act 1991.

[4] As per paragraph 6.15 of Ofgem's Statement of Methods, Ofgem would "*apply a relatively high evidential bar to any conclusion that the RCBs outweigh any prejudice arising from the merger*".

detailed information requests in draft form with a short window for the parties to provide comments on, for example, the availability of the data in the format requested or to seek clarifications on particular questions has been a useful development in practice that has assisted both the CMA and the merging parties in promoting efficient and effective information gathering. We would recommend that this practice is incorporated for energy network mergers and reflected in the Draft Guidance.

(12) We would also welcome further clarity on the extent of information exchange between the CMA and Ofgem at different stages of the process. As currently drafted, the Draft Guidance only states that "*the CMA and Ofgem may, where appropriate, discuss with each other energy network merger issues that the merging parties bring to their attention*" (Paragraph 3.5). From our experience in transactions under the special water merger regime, it was often unclear how much the CMA and the sectoral regulator had engaged with each other during the pre-notification process. This made communication lines difficult to navigate (such as one regulator informing the merging parties that there was outstanding information awaited by the other regulator, without being able to provide further information).

(13) This necessity for greater transparency on the nature of the engagement between both regulators goes hand in hand with a clearer understanding of Ofgem's role, especially in Phase 2 (as outlined in **Section 2** above).

(14) We would further discourage blanket requirements for merging parties to share all information with Ofgem and the CMA at the same time (as currently prescribed by paragraph 8.15 of Ofgem's Statement of Methods). The CMA process is independent from Ofgem's and it is not always appropriate to automatically send all information required by the CMA to Ofgem in parallel. For example, merging parties may have concerns in relation to sharing confidential information (which is not directly relevant to Ofgem's assessment) with Ofgem where a price control process is underway.

4 The process for parallel merger reviews

(15) We note that under Paragraph 1.3 of the Draft Guidance, where the businesses of both merging parties involve energy network enterprises of the same type as well as other activities, the CMA will consider the parts of the transaction relating to the overlapping energy network enterprises under the special energy network merger provisions and the parts of the transaction relating to the parties' other activities under the general merger provisions of the EA02. We would welcome further guidance on how this would work in practice, especially in relation to the timelines of both merger reviews and when the statutory clocks will commence. To the extent possible, we would encourage the timetables to be run independently. For example, pre-notification discussions are likely to be complex in an energy network merger environment (which the CMA recognises in Paragraph 3.9). We invite further guidance from the CMA on the specific role of Ofgem in this scenario, including the preferred sequencing for submission of drafts.

(16) Conversely, if the activities caught by the EA02 are ancillary in nature, a more streamlined pre-notification period would be merited for this aspect of the transaction. A delay (or increased complexity) in one regime should not delay the timetable of the other.

(17) Furthermore, we would encourage the CMA to clarify how it intends to staff cases in parallel merger review procedures (under the EA23 and the EA02). Whilst we acknowledge that a single case team would support a cohesive and comprehensive approach, the "standard" size of the case team may need to be adjusted to reflect the fact that the CMA will be considering two separate statutory frameworks. In the case of completed mergers, the CMA would have the added complexity derived from any initial enforcement orders in place. A

one-size-fits-all case team risks creating delays in either or both reviews (especially in periods where resourcing is typically constrained, such as over the summer or festive holidays). Further guidance on how the CMA proposes to deal with timeline delays where there are parallel merger processes or where there is more than one applicable statutory clock would be helpful.[5]

(18) Paragraph 1.3 further states that in the case of a parallel merger review, "*the CMA will endeavour to investigate the cases together.*" Likewise, footnote 4 notes that Section 68E of the EA02 "*makes provision*" for the CMA to make combined references under the energy network merger regime and the general merger regime, in which case the same group may consider the Phase 2 references jointly. We would welcome further clarity in relation to the circumstances which would prompt this outcome. For example, it would be helpful to understand if the default position is that the CMA will investigate the cases together unless the circumstances prohibit it, or at the request of the merging parties.

5 Other procedural aspects

(19) We consider that there is scope for further refinement with regard to the CMA's treatment of UILs, RCBs and remedies under the energy network merger regime and we include below our proposed recommendations.

5.1 UILs

(20) As outlined in **Sections 2 and 3** above, further guidance on the weight given to Ofgem's opinion at the UILs stage, as well as on the extent of the engagement between the CMA and Ofgem on any proposed UILs, would be useful.

(21) We would also encourage the CMA to clarify the length of any public consultation in relation to UILs (and whether this period is in working or calendar days), as the Draft Guidance does not currently specify this (or refer to other CMA guidance on this point).

5.2 RCBs

(22) Paragraph 5.8 of the Draft Guidance notes that "*it is not sufficient that there are merely some theoretical benefits to customers: the merging parties must demonstrate that benefits will be passed on to customers and that those benefits will outweigh the identified prejudice*". Whilst we recognise that the CMA might not be well-placed at this stage to give detailed examples on RCBs in an energy network merger, we would welcome any indication in relation to the types of evidence that the CMA would expect to receive for determining whether any RCBs proposed by the parties amount to "qualifying" RCBs. This would be separate to the assessment of whether those RCBs outweigh the prejudice identified.

(23) We note that Ofwat's approach to mergers and statement of methods (the "**Ofwat Statement of Methods**") gives examples of relevant customer benefits, such as "*improving security of supply*", and lists specific customer benefits that are more likely to be relevant, such as license modifications.[6] Similar guidance in respect of energy network mergers would be helpful.

5.3 Remedies

(24) As with UILs above, we would find further guidance on the extent of the engagement between the CMA and Ofgem on any remedies extremely useful during the Phase 2 process.

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[5] There will be more than one applicable statutory clock, for example, in the case of a completed merger: (i) four months from the merger being made public or it being completed (whichever is the later) for the CMA to decide whether to refer the merger for an in-depth Phase 2 investigation and (ii) 40 working days for the CMA to complete its Phase 1 investigation.

[6] Ofwat, *Ofwat's approach to mergers and statement of methods*, October 2015.

We note that Paragraph 6.4, which addresses the CMA's approach to remedies at Phase 2, currently does not mention any interaction with Ofgem. If Ofgem were to have a role in the assessment of remedies, merging parties should be provided access to any relevant analysis undertaken by Ofgem and underlying data to enable their own external experts to test the conclusions, conduct parallel cross-checks and undertake alternative assessments. Should there be confidentiality concerns, the CMA could limit disclosure to a selected and ring-fenced group of external advisers acting for the merging parties.

6 Conclusion

(25) As noted above, we welcome the CMA's willingness to engage with practitioners and other stakeholders with respect to the Draft Guidance. However, we consider that there is scope for the Draft Guidance to be further refined in the areas outlined above and that addressing these would bring greater clarity to certain aspects of the energy network merger regime.

Linklaters LLP – 24 January 2024