HERBERT SMITH FREEHILLS

8 January 2024

CMA consultation

Mergers: Exception to the duty to refer – Consultation document of 20 November 2023

Response

1. INTRODUCTION

1.1 Herbert Smith Freehills LLP welcomes the opportunity to provide comments on the Competition and Markets Authority's ("**CMA**") consultation document of 20 November 2023 on Mergers: Exception to the duty to refer in markets of insufficient importance ("**Consultation Document**"). The Consultation Document proposes to replace the current guidance (Mergers: Exception to the duty to refer (CMA64)) ("**Current Guidance**") with the draft revised guidance set out in the document published by the CMA on 20 November 2023 ("**Draft Revised Guidance**").

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

2. RESPONSE TO QUESTIONS FOR CONSIDERATION

2.1 **Question 1: Is the content, format and presentation of the Draft Revised Guidance sufficiently clear? If there are particular parts of the Draft Revised Guidance where you feel greater clarity is necessary, please be specific about the sections concerned and the changes that you feel would improve them.**

2.1.1 We do not have any comments on the form or presentation of the Draft Revised Guidance. Our comments on specific revised proposals can be found below in the response to Question 2.

2.2 **Question 2: Do you agree with the approach to applying the de minimis exception set out in the Draft Revised Guidance?**

2.2.1 We have a number of specific comments on the revised approach to applying the de minimis exception contained in the Draft Revised Guidance. These are outlined below.

Proposal for a single threshold

2.2.2 The CMA is proposing to remove one of the two thresholds in the Current Guidance in order to retain a single threshold of £30 million. The effect of this change will be to remove the distinction between transactions falling below the lower threshold (currently £5 million), where the CMA "*will generally not consider a reference justified*"[1] and those falling between the lower and higher thresholds (between £5 million and £15 million) for which the CMA applies a cost/benefit analysis.[2]

2.2.3 In principle we do not see any clear objections to this approach. However, please see our comments below regarding the proposed "*Size of the market*" factor, at 2.2.15(A).

1 Per the Current Guidance, paragraph 9.
2 Current Guidance, paragraph 10.

Proposal for revised threshold

2.2.4 The CMA is proposing to increase the threshold above which it considers that the market(s) concerned will generally be of sufficient importance to justify a phase 2 reference from £15 million to £30 million.

2.2.5 We are broadly in support of raising the market size threshold and believe that it is appropriate for the threshold to be adjusted periodically to ensure that it reflects the impact of inflation within the UK. As noted in the Consultation Document, the increase is consistent with the proposed increase to the turnover test threshold for jurisdiction contained in the Digital Markets, Competition and Consumer Bill.

2.2.6 However, we consider that the proposal does not go far enough. At the proposed revised threshold level, the CMA could still refer very small transactions in small markets for an in-depth Phase 2 investigation. We see no reason in principle why the threshold should not be raised further (even doubled to £60 million) to ensure the exemption is available to the CMA in more cases.

Removal of the requirement for no clear-cut undertakings in lieu of a reference ("UILs") to be available

2.2.7 The CMA is proposing to remove the requirement for there to be no clear-cut UILs to be available for the application of the de minimis exception.

2.2.8 As a point of principle, we welcome changes that recognise the distinction between the CMA's analysis of substantive concerns (i.e., the assessment of whether the transaction gives rise to a substantial lessening of competition ("**SLC**")), potential remedies thereof (including UILs) and the question of whether transactions are sufficiently important to merit the cost and administrative burdens of a Phase 2 investigation. Doing so is likely to produce more robust conclusions which are explicable and stand on their own merits, rather than conclusions that conflate an assessment of substantively different issues.

2.2.9 With this in mind, we support the removal of the requirement that UILs should not be available in order for the de minimis exception to be applied. The availability of UILs is unrelated to the importance of the market or the size of the transaction and the current requirement that UILs should not be available conflates the questions of whether the CMA *could* require remedies with that of whether it *should* do so. It also avoids scenarios where potentially highly subjective questions about the availability of UILs can impact on the availability of the de minimis exception.

2.2.10 For example, where a UIL might involve the disposal of part of an acquired business, the acquirer may consider that such a disposal would completely remove the commercial rationale for the acquisition, such that a UIL of that nature should not be considered "available", whereas the acquired business, its seller, or the CMA might subjectively take a different view. Documentary evidence of the acquirer's view is likely to be sparse unless the acquirer happens to have specifically considered the possibility of the divestment – and in that case, it is likely that the relevant material would be legally privileged due to forming part of the advice received by the acquirer from its legal advisers. Thus, removing the requirement avoids this uncertainty.

2.2.11 Removal of this requirement will also allow the CMA to consider relying on the de minimis exception at an earlier stage and for the decision to apply the exception to link more closely to evidence available to the CMA at the early stages of its review. This refocuses the purpose of the de minimis exception as a means of identifying

markets of insufficient importance, rather than as a possible "remedy" in cases where an SLC has already been identified and, as such, should remove inconsistent drivers in its application. If removal of this requirement is used to enable earlier resolution of investigations, there would likely be benefits to both parties and the CMA in terms of avoiding the wasted effort of carrying out a full merger control review in markets of insufficient importance.

2.2.12 From the perspective of the UILs process, separating the question of UILs from the de minimis exception avoids creating scenarios in which parties are disincentivised from developing an offer of UILs. Currently, it is conceivable that parties may consider it to be in their interest to advocate against the availability of UILs so as not to preclude the possibility of a de minimis exception, whereas no such disincentive would apply if the CMA's proposal were adopted. Again, this is an example of how separating the different questions that the CMA must answer leads to a better outcome both for the parties and for the CMA's enforcement of the merger control regime.

Replacement of the cost/benefit analysis with three factors

2.2.13 The CMA proposes to replace the cost/benefit analysis applied under the Current Guidance with three factors intended to assess the importance of the markets concerned rather than the extent of the CMA's competition concerns in those markets.

2.2.14 We broadly support the replacement of the current cost/benefit analysis with the three factors. This change further refocuses the main concern of the application of the de minimis exception on the importance of the market(s) concerned in the transaction and moves the analysis away from the likelihood of a referral to a phase 2 investigation or the finding of a SLC.

2.2.15 However, we raise below specific concerns regarding the individual proposed factors:

(A) *Size of the market*: Our main concern regarding this factor is how it is intended to interact with the £30 million threshold. If the CMA can deem the size of the market "too large" under this factor, although the size of the market is below £30 million, this begs the question as to why that threshold exists at all and undermines the benefits achieved by simplifying the current two thresholds into one.

In order for the benefits of a single threshold to be achieved, it is important that the single threshold actually has effect as such i.e., where a transaction falls within the threshold, it should not generally be necessary to give further consideration to the size of the transaction or the market within which it takes place. To do otherwise would be to reintroduce different thresholds, but without even the clarity that having a specific lower threshold offers. For this reason, we propose removing the "size of the market" factor altogether.

Should the CMA not be minded to adopt this proposal, it should provide further guidance on how this factor is intended to be applied, clarifying that this factor would not be applied in a way which would undermine the purpose of the threshold. As a minimum, it should be made clear that the de minimis exception will not be precluded solely based on the size of the market in cases where the £30 million threshold is not exceeded.

(B) *Replicability*: We agree that whether the merger is one of a potentially large number of similar mergers that could be replicated across the sector(s) in question is a relevant factor to the de minimis exception. We understand the CMA's concern regarding the applicability of the de minimis exception in markets where a string of transactions might benefit from the exception in isolation, but where the market is becoming prone to increased consolidation by a few acquiring parties.

That said, the CMA's current approach raises several difficulties which we have sought to address below:

(1) The Draft Revised Guidance must be clear on when replicability becomes a problem. We believe that replicability might become a concern if there is actual significant market consolidation by multiple parties, or where one party is seeking to build a significant, market-leading presence through a series of smaller transactions. The mere possibility of replication cannot be enough, as this alone is purely hypothetical.

(2) The Draft Revised Guidance must also make clear what evidence is appropriate to show replicability in those circumstances, which is currently absent in the draft. Without this, a transaction could fail to satisfy this factor even though the parties to it are unaware of the trend in these market(s). Appropriate evidence could include previous transactions in the same market(s), clear public statements from parties about prospective transactions, or of course the parties' own intelligence on market developments.

(C) *Nature of the potential detriment*: We believe that the CMA should provide more specific examples in its Draft Revised Guidance of the type and/or gravity of the potential detriment which would lead it to exclude the de minimis exception. The CMA's Annual Plan includes broad priorities, including ensuring consumers are getting "great choices" and ensuring the UK economy grows productively and sustainably. Priorities expressed in such vague terms could preclude the application of the de minimis exception to virtually any transaction.

2.3 **Question 3: Do you have any other comments on the Draft Revised Guidance?**

2.3.1 More broadly, we support the proposal for the CMA to use the de minimis guidance at different stages of the CMA's review, including at the intelligence stage (see paragraph 2.6. the Consultation Document) through the mergers intelligence function ("**MIF**"). We agree that this will enable the CMA to focus on those transactions which are of sufficient importance within the market(s) involved as to merit CMA review.

2.3.2 We would also welcome clear communication from the MIF with the parties to a transaction when it has reached the conclusion that a transaction is likely to fall within the de minimis exception. A confirmation to this effect would enable merger parties to understand the MIF's reasoning and therefore better self-assess the circumstances in which the CMA may ultimately choose to review the transaction.

Herbert Smith Freehills LLP
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