ALERT MEMORANDUM

CMA Ramps Up Merger Control Enforcement Ahead of Brexit

The UK's Competition and Markets Authority (CMA) is strengthening its approach to merger control as it prepares for its new status as a global enforcer with expanded jurisdiction.

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Following the UK's departure from the EU on 31 January 2020, the UK entered a transition period due to end on 31 December 2020.[1] EU competition law continues to apply in the UK until the transition period ends (and to mergers notified to the European Commission before the end of that period), meaning that the European Commission continues to have exclusive jurisdiction over transactions with an EU dimension, including those impacting UK markets.

The UK Government has said that it will not extend the transition period beyond 2020.[2] Accordingly, as of January 2021, the CMA expects to have jurisdiction over transactions currently subject to exclusive review by the European Commission that meet UK's merger control law's thresholds. The CMA expects a 40-50% increase in its annual mergers workload, meaning an additional 30-50 Phase 1 investigations and an additional six or so Phase 2 investigations.[3]

Over the past three years, the CMA has made a concerted effort to upgrade its capabilities.[4] Among other things, it has moved to new premises in Canary Wharf and has increased its staff by almost 40%, bringing the total headcount to over 850 (compared with 800 at the European Commission's Directorate-General for Competition). It has also shown a greater readiness to assert jurisdiction over transactions, to penalize procedural violations, and to challenge mergers that might previously have been approved unconditionally. The CMA's more interventionist enforcement practice is likely to affect many global transactions following the end of the transition period.

[1] European Union (Withdrawal Agreement) Act 2020
[2] *See* Reuters, UK will not extend Brexit transition period - Johnson's spokesman, January 6, 2020.
[3] *See* Andrea Coscelli on the CMA's role as the UK exits the European Union, February 4, 2017
[4] *See* Competition and Markets Authority Annual Plan 2019/2020

Expansive approach to jurisdiction. The CMA has jurisdiction to review a transaction if the business being acquired had UK turnover of more than £70 million or if a transaction would result in the creation of, or would increase, a combined share of supply of any goods or services in the UK of at least 25%.[5] Critics have said that these jurisdictional thresholds leave the CMA powerless to review some of the most prominent global acquisitions, such as in the digital markets industry, where target companies often have minimal revenues and low market shares.[6] The recent Furman Report[7] noted that the five largest digital firms had acquired more than 400 companies over the last 10 years, but only a few of these acquisitions were reviewed by the CMA.

The CMA has responded to these concerns by adopting an increasingly expansive and creative approach in the way it applies the 'share of supply' test. In *Sabre/Farelogix*,[8] the companies had only a small presence in the UK, but the CMA asserted jurisdiction on the basis that they both provided IT services to a single UK airline, British Airways. In *Roche/Spark*,[9] the CMA asserted jurisdiction over a transaction in which the target did not have any existing products that competed with Roche but was in the process of developing a gene therapy expected to compete with Roche in future. The CMA asserted jurisdiction based on the companies' share of UK-based employees engaged in activities relating to the relevant gene therapy.

By using broad categories of 'products' or 'services', and by placing greater importance on potential competition, the CMA is testing the boundaries of its jurisdictional powers. If unchecked by the courts, this approach will enable the CMA to assert jurisdiction over transactions that would previously have been understood to fall outside the scope of UK merger control.

Hold-separate orders. The CMA may impose hold-separate orders, referred to initial enforcement orders (IEOs),[10] at any stage of an investigation.[11] The CMA's standard practice is to impose IEOs on all completed mergers, as well as on anticipated mergers in which it determines that there is a risk of the companies taking steps that would be prohibited if a standard IEO were in place. If the CMA considers

[5] The CMA does not have to establish that the jurisdictional test is met before carrying out an investigation, only that it has a reasonable basis for suspecting that it may be. To open a phase 2 investigation, it need only show that there is a "realistic prospect" that the test is met.

[6] Lower jurisdictional thresholds apply if the enterprise being acquired (or part of it) is active in the development or production of items for military or military and civilian use, quantum technology and computing hardware. The CMA can review those acquisitions if (i) the target's annual UK turnover exceeds £1 million, (ii) the 'share of supply' test is met, or (iii) the target has a pre-merger share of supply of at least 25% in those activities in the UK (*i.e.*, even if there is no increase in the share of supply as a result of the merger). *See* The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 (SI 2018/578) and The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018 (SI 2018/593).

[7] Unlocking digital competition. Report of the Digital Competition Expert Panel. March 2019

[8] ME/6806/19 Anticipated acquisition by Sabre Corporation of Farelogix Inc

[9] ME/6831/19 Anticipated acquisition by Roche Holdings, Inc. of Spark Therapeutics, Inc

[10] Although IEOs generally operate as hold-separate orders, their remit can be much broader: they give the CMA the power to prevent or unwind any "pre-emptive action", which is defined as any action which might prejudice the outcome of a pre-notification. There is no exhaustive list of the kinds of conduct that may amount to pre-emptive action, but the CMA provides some examples in its interim measures guidance: "Depending on the nature of the business, pre-emptive action might include actions such as closing or selling sites; selling or failing to maintain equipment; degrading service levels; failing to retain key employees; integrating IT systems; failing to compete at arm's length for tenders; integrating customer-facing functions; weakening the independence of brands; discontinuing competing products; or exchanging confidential commercially sensitive information." CMA108, Interim Measures in Merger Investigations, footnote 1.

[11] See section 72 of the Enterprise Act 2002. The CMA only needs reasonable grounds for suspecting that "arrangements are in progress or in contemplation", which if carried into effect, will result in two or more enterprises ceasing to be distinct. The CMA can impose an IEO at any time before a Phase 2 reference. Once a reference to Phase 2 has been made, the IEO remains in force unless the CMA decides to impose an Interim Order or accept an interim undertaking (typically where no IEO was imposed at Phase 1 or where it is necessary to vary the terms of the IEO). Interim Orders are not always necessary at Phase II, since the Enterprise Act 2002 prevents the parties to a merger from acquiring any interest in shares (but not assets) in a company to which the reference relates without the CMA's consent.

that the merging companies lack the ability or willingness to comply with its IEO, it may appoint a monitoring trustee to monitor and prepare regular reports on compliance.[12] A failure to comply with an IEO can result in fines of up to 5% of total global group turnover.

Over the past 18 months, the CMA has for the first time penalized companies for breaching IEOs (by, among other things, appointing unauthorized staff and engaging in joint marketing). Since June 2018, the CMA has fined Ausurus,[13] JLA,[14] Nicholls' (Fuel Oils),[15] PayPal,[16] and Electro Rent (two separate fines),[17] between £100,000 and £300,000 each.

Extensive requests for internal documents. Unlike in the United States, where the federal agencies routinely issue broad 'Second Requests' that require the disclosure of very significant numbers of documents, the CMA has historically assessed transactions largely on the basis of written submissions from merging companies and other industry participants. That is changing. Last year, the CMA issued new guidance on requests for internal documents.[18] The guidance states that the CMA may—at any stage of its investigation—request any document in the merging parties' possession that has been prepared, sent, or received by an officer or employee (including emails, internal analysis, instant messages, and handwritten notes). Since the publication of its guidance, the CMA has made increasingly burdensome document requests at early stages of its merger investigations (including during pre-notification). It is now common to receive requests for internal emails and draft documents, often extending to thousands of pages. As the CMA prepares to take jurisdiction over larger mergers currently reviewed by the European Commission, it is also developing its internal IT capabilities to handle the vast volumes of documents that it anticipates receiving.

Companies should be aware of the considerable time and resources that may be taken up in responding to the CMA's requests for information. This can be challenging, particularly given the CMA's tight deadlines for responding, and the fact that mergers are often subject to parallel—and rarely identical—requests for information from multiple competition authorities.

Penalties for failing to provide internal documents or respond to information requests. The CMA is making greater use of its statutory power to issue formal information requests under s.109 of the Enterprise Act 2002.[19] In its recent guidance, the CMA made clear that it intends shifting from making informal requests to using s.109 notices, which compel companies to respond within a prescribed deadline.[20] Companies that fail to provide complete

[12] At Phase 1, the CMA usually appoints a monitoring trustee if it has concerns about the ability or willingness of the merging parties to comply fully with an IEO, or if it identifies a significant risk of preemptive action. At Phase 2, the CMA will normally require a monitoring trustee to be appointed in completed mergers unless the merging parties can provide compelling evidence as to why there is little risk of pre-emptive action.

[13] Case ME/6712-17 Completed acquisition by Ausurus Group Ltd of CuFe Investments Ltd, 20 December 2018, Decision to impose a penalty on Ausurus Group Ltd and European Metal Recycling Ltd under section 94A of the Enterprise Act 2002, 20 December 2018

[14] Case ME/6792/17 Completed acquisition by JLA New Equityco Limited through its subsidiary Vanilla Group Limited of Washstation Limited, Decision to impose a penalty on JLA New Equityco Limited and Vanilla Group Limited under section 94A of the Enterprise Act 2002, 8 March 2019

[15] Case ME/6762/18 Completed acquisition by Nicholls' (Fuel Oils) Limited of the oil distribution business of DCC Energy Limited in Northern Ireland, Notice of a penalty pursuant to section 94A of the Enterprise Act 2002, 28 June 2019

[16] Case ME/6766/18, Completed acquisition by PayPal Holdings, Inc. of iZettle AB, Notice of penalty pursuant to section 94A of the Enterprise Act 2002, 24 September 2019

[17] Case ME/6676-17, Notice of penalty pursuant to section 94A of the Enterprise Act 2002 – addressed to Electro Rent Corporation, 11 June 2018 and 12 February 2019

[18] CMA 100, Guidance on requests for internal documents in merger investigations

[19] Enterprise Act 2002, section 109.

[20] CMA 100, Guidance on requests for internal documents in merger investigations, paragraph 16: "The CMA's practice in relation to whether to request internal documents using informal or statutory requests has varied in previous investigations. To support the CMA's ability to carry out its statutory functions, which is dependent, in large part, on being able to rely on the accuracy and comprehensiveness of merging parties' submissions, the CMA is likely to use section 109 notices as standard in future investigations where internal documents are

responses to s.109 notices may be subject to a fixed fine of up to £30,000 and/or daily fines of £15,000. The CMA may also 'stop the clock', effectively extending the statutory deadline for completing its investigation, if it determines that a company has failed to provide a complete response.

Over the past three years, the CMA has for the first time imposed penalties on companies that failed to comply with formal information requests.[21] The fines have ranged from £15,000 to £27,000, all for failure to provide full responses to information requests by the CMA's deadline. The CMA has, thus far, pursued cases in which it sees a pattern of non-compliance. In many cases, the CMA has 'stopped the clock' pending the production of a response.[22]

Companies should take into account the prospect of fines, reputational harm, and delays to closing the transaction for perceived failures to respond to the CMA's information requests. Where possible, it is prudent to encourage the CMA to share draft notices in order to discuss the scope and timing of its requests before the final s.109 notice is issued.

Finally, unlike appeals of CMA clearance or prohibition decisions, the Competition Appeal Tribunal (CAT) is not limited to a judicial review standard (*e.g.*, rationality) in reviewing CMA decisions.[23] This means that the CAT will effectively carry out a merits review and consider 'de novo' whether companies had an objectively reasonable excuse for failing to comply with the CMA's information request.

Interim orders to unwind completed mergers. Last year, the CMA exercised for the first time its power to require parties to unwind steps taken to implement a merger while the CMA carried out its investigation. In March 2019, the CMA imposed an unwinding order on *Tobii/Smartbox*, a merger between suppliers of augmentative and assistive communication devices. The order required the parties to terminate a reseller agreement and Smartbox to reinstate its R&D projects and resume the sale of discontinued products. In August 2019, the CMA imposed an unwinding order in *Bottomline/Experian*, a merger of payments software suppliers. It required Bottomline to segregate all EPG confidential information and refrain from using any commercially sensitive information relating to the EPG business to solicit customers. The CMA made this order before the Phase 1 process had begun.

When considering whether to notify a transaction to the CMA, companies should consider potential unwinding costs should the CMA decide to investigate. In *Bottomline/Experian*, for example, the CMA's unwinding order effectively forced Bottomline to recreate two separate business units with separate management and IT systems in order to comply with the order. The costs of creating a stand-alone business unit that maintains discrete product or service standards may be challenging, particularly for small and medium-size companies.

A more interventionist enforcement practice. The CMA's substantive assessment has become less permissive and more stringent, as the following three examples make clear.

- In S*ainsbury's/Asda*,[24] the CMA blocked the proposed merger of two of the UK's four national supermarket retailers, finding that the transaction would lead to higher prices in stores, online, and at many petrol stations. Instead of assessing the merger's impact on local markets only—as had been its usual practice in retail mergers—the CMA took account of national theories of harm. It also rejected the merging parties' argument that discounters (such as Aldi and Lidl) and

requested from main parties in both Phase 1 and Phase 2 merger investigations"

[21] The CMA has imposed fines under section 110 of the Enterprise Act 2002 in the following cases: *JUST EAT/Hungryhouse*, *AL-KO Kober/Bankside Patterson*, *Rentokil/MPCL*, *Sabre/Farelogix*.

[22] For example, see *Refresco Group/Cott*, *Flogas/Countrywide*, *AL-KO Kober/Bankside Patterson*.

[23] Decisions to impose penalties for failure to comply with a notice to provide evidence under s.110(1) or (3), which are excluded from the general rights of review under ss.120 and 179, are subject to a dedicated avenue of appeal in s.114 of Enterprise Act 2002. In the case of [2019] CAT 4 Electro Rent Corporation v CMA, the CAT decided that, although s.114 of the Enterprise Act 2002 does not set out the standard of review that should be applied, it is not limited to judicial review (at paragraph 68).

[24] ME/6752-18 Anticipated merger between J Sainsbury Plc and Asda Group Ltd

online retailers would pose a sufficient competitive constraint post-merger.

- In *Ecolab/Holchem*,[25] the CMA blocked a completed merger in which the parties' combined market share was below 40%, finding that the transaction would reduce competition in the market for the supply of cleaning products to food and beverage customers. The CMA rejected Ecolab's proposed remedy to transfer some customers and assets to a rival. Instead, it ordered Ecolab to divest at least 90% of Holchem.
- In *JD Sports/Footasylum*,[26] the CMA has provisionally found[27] that the completed merger could reduce competition in sports-inspired clothing and footwear. It has treated the transaction as a three-to-two merger, provisionally finding that, aside from Foot Locker, other retailers[28] do not exert a strong competitive constraint on the parties. It is considering whether to block the deal and potentially requiring JD Sports to sell Footasylum in its entirety.

Conclusion

The CMA is soon likely to have jurisdiction over some of the largest global mergers. Its expansive approach to jurisdiction, burdensome requests for information, strict procedures, and increasingly interventionist approach may be expected to increase the costs and burden on companies engaging in transactions subject to global merger control.

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[25] ME/6793/18 Completed acquisition by Ecolab Inc. of The Holchem Group Limited
[26] ME/6827/19 Completed acquisition by JD Sports Fashion plc of Footasylum plc
[27] The CMA published its provisional findings on February 20, 2020. These findings may change by the time the CMA reaches its final decision.
[28] Including multi-brand retailers such as Sports Direct and Schuh, mono-brand retailers such as Nike and Adidas, and other online retailers such as Zaldano.