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Quickguides

UK merger control: Phase 2 references

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Quickguide overview

When a merger is referred for an in-depth Phase 2 investigation under the UK merger control regime, the Competition and Markets Authority's duty is to investigate and decide whether the merger has resulted in, or may be expected to result in, a substantial lessening of competition.

This guide summarises the Phase 2 investigation process under the Enterprise Act 2002. Topics covered include:

- Phase 2 procedure;
- the provisional findings, remedies and decision;
- restrictions on the parties during the inquiry; and
- confidentiality.

For further information on any of these areas please speak to one of the contacts listed on the final page of this Quickguide, or your usual Ashurst contact.

Brexit

The UK left the EU on 31 January 2020 and the Brexit Transition Period ended on 31 December 2020. On 1 January 2021, the UK and EU became two fully distinct regulatory, legal and customs territories, whose relationship is governed by the Trade and Cooperation Agreement (TCA).

This means that the UK is no longer part of the EU for jurisdictional, procedural and substantive assessment purposes under the EU Merger Regulation (EUMR). In particular, the "one-stop shop" system established under the EUMR no longer applies to the UK, meaning that the UK Competition and Markets Authority (CMA) is now permitted to investigate transactions in parallel with the European Commission.

UK merger control: Phase 2 references

1. Introduction

UK merger control legislation is primarily contained in the Enterprise Act 2002 (EA 2002) and is enforced (since 1 April 2014) by the CMA.

In common with a number of other jurisdictions, UK merger control is a two-stage process. An initial review considers whether the merger raises prima facie competition concerns (a "Phase 1" investigation), with a second stage in-depth review for more contentious mergers (a "Phase 2" investigation). Both stages of the review process are handled by the CMA. This Quickguide provides an overview of the Phase 2 investigation, whilst further details on the wider UK merger control regime, including more detail on the Phase 1 process, are set out in *Ashurst's Quickguide: UK merger control*.

2. The Phase 2 reference

The CMA's duty to refer

The CMA is under a duty to refer a relevant merger situation for a Phase 2 investigation where the CMA believes that it is, or may be, the case that:

- a relevant merger situation has been created, or arrangements are in progress which if carried into effect will result in the creation of a relevant merger situation; and
- the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC) within any market(s) in the UK for goods and services.

The CMA has a wide margin of discretion whether to refer cases where the risk of a merger leading to a SLC is believed to be more than fanciful but less than 50 per cent. In practice, the CMA will refer a merger where it considers that there is a "realistic prospect" of a SLC. Above a 50 per cent risk, a reference must be made.

The CMA considers that a merger may be expected to lead to a SLC when it is expected to weaken rivalry to such an extent that customers would be harmed. This may come about, for example, through reduced product choice, or because the merged business could profitably raise prices, reduce output and/or product quality or reduce innovation. The CMA has also indicated that it considers that the core analysis under the SLC test is a comparison of whether the conditions of competition in the relevant market are better with or without the merger. Further information about the substantive assessment of mergers may be found in *Ashurst's Quickguide: Substantive economic analysis in merger control*. See also *Ashurst's Quickguide: UK merger control* for information on the exceptions to the CMA's duty to refer a merger to a Phase 2 investigation.

The "fast track" reference procedure

The CMA also has a "fast track" reference procedure where, exceptionally, the treatment of cases for referral for a Phase 2 investigation may be accelerated at the request of the parties and where there is sufficient evidence to meet the CMA's statutory threshold for reference. Where such a request is accepted, the CMA will aim to make the reference decision within 10 to 15 working days following receipt of a complete notification.

3. The CMA Inquiry Group

The CMA Board (which will normally delegate decision-making powers to a senior CMA officer) is responsible for making Phase 1 decisions, including the decision to refer a merger to a Phase 2 investigation. At Phase 2, however, an Inquiry Group (comprising between three and five Panel Members of the CMA, appointed for the merger in question) is created and is responsible for Phase 2

decisions. The CMA Panel comprises people with the requisite depth of experience through their work as professional or academic lawyers, economists, accountants, directors or other business roles.

None of the members of the Inquiry Group will have been involved in the Phase 1 investigation, so that they will approach the transaction with a "fresh pair of eyes". However, at a case-team level, there will generally be a degree of overlap between Phase 1 and Phase 2 case team members, in order to avoid unnecessary duplication and to facilitate an efficient end-to-end merger review process.

4. Duration of the inquiry

The CMA has 24 weeks, beginning with the date of the reference, to undertake its Phase 2 analysis and to prepare and publish its final report and decision (including with regard to remedies). One extension of no more than eight weeks may be allowed. Historically, Phase 2 investigations have generally taken at least 20 weeks and usually the full 24 weeks. There is no option to speed up this Phase 2 process.

5. Procedure

The CMA's opening letter

Following the announcement of the reference, the CMA will send each of the parties to the reference (the "main parties") an initial letter (also known as the "Phase 2 opening letter"). The Phase 2 opening letter follows a relatively standard form and marks the formal start of the Phase 2 inquiry. It will notify the main parties of the members of the Inquiry Group for the particular reference and cover other administrative details such as availability during the inquiry period. Although the CMA will continue to refer to information gathered during the Phase 1 investigation, the Phase 2 opening letter will also request initial information/data.

The initial request for information

The deadline for responding to the request for initial information/data is typically one week or so. The data request will be individually tailored for each case and will depend on the extent of information gathered during Phase 1. However, the information request may cover such materials as annual reports and accounts, shareholder documentation issued in relation to the transaction, press releases about the merger, any legal agreements documenting the merger (or draft agreements), any market research reports about the markets in question, and any board papers, presentations, board minutes or other papers prepared in relation to the transaction, to the extent not already provided to the CMA. Where the CMA considers the information already provided in full at Phase 1 to be sufficient for the purposes of the Phase 2 inquiry, it will not ask the main parties to submit it again, but may ask for the information to be updated to cover the time period since its original submission.

The initial submission/ response to Phase 1 decision

The opening letter will invite the main parties to make an initial submission setting out their principal arguments and evidence. Historically this initial submission would summarise much of the material presented during Phase 1, but it is now more common for this document to be a focused response addressing the areas of concern identified in the Phase 1 reference decision. It is still open to the parties to submit a more detailed initial submission, but the CMA is usually content to rely on the contents of the merger notice and other evidence gathered at Phase 1.

The main parties are typically asked to respond to the CMA within two to three weeks of the announcement of the reference, although it may be possible to request a short extension. The CMA expects its strict timetable to be adhered to and it can be difficult for the CMA to grant extensions of deadlines in the absence of good reasons.

The case management meeting and data meeting

In the Phase 2 opening letter, the CMA will also invite the main parties to a "case management meeting" with the case team to discuss the timetable and administrative arrangements, and a data meeting to discuss what (if any) relevant additional or updated data may be available.

Administrative timetable

In the first few weeks of the Phase 2 inquiry, the CMA will create an administrative timetable and will invite the main parties to comment on this. After consultation with the main parties, the CMA will publish the timetable on its website.

Requests for further information – the questionnaires

In addition to the initial submission(s) which they make, the main parties will also receive detailed requests from the CMA for information about various matters. In particular, as soon as practicable after the reference the CMA will issue a financial questionnaire and a market questionnaire, with a deadline for responding of two to three weeks.

The market information will typically request information on customers, suppliers, product characteristics, market shares, competition, pricing, marketing and barriers to entry, expansion and exit. It will usually also contain (or be supplemented by) an initial data request focusing on the quantitative information at the main parties' disposal that will enable the CMA's competition analysis, e.g. sales figures, pricing information and cost data. The financial questionnaire is likely to focus on financial performance and projections, including margin calculations.

Further questions may be raised throughout the duration of the inquiry.

The site visit

The Inquiry Group and a selection of the case team usually wish to attend a site visit to see one or both of the merging parties' facilities, usually in the first six weeks following the reference. These visits are relatively informal, and aim to provide an overview of the parties' businesses. The parties are encouraged to give a short presentation on the nature of the business and context in which the merger takes place, prior to the tour of the site. The CMA guidance states that parties may also wish to present their initial views on the relevant competition issues as they see them.

Site visits may often be of benefit to the main parties as well as to the CMA, giving the parties the opportunity to explain their business and putting across points in a way not so easily achieved either at oral hearings or in formal submissions. Moreover, site visits are likely to be the first chance to meet the Inquiry Group members.

The issues statement

Once the CMA has completed the initial evidence/information gathering exercise, it will issue an "issues statement" which will set out one or more theories of harm which will form the framework for the CMA's competitive analysis at Phase 2, and outline the issues which the inquiry will be exploring. It will typically cover the areas of market definition, the dynamics of the market including rivalry between competing suppliers, entry barriers, competitive effects of the merger and the likely development of the market in the absence of the merger. It may also address the question of whether there are any potential relevant customer benefits resulting from the merger.

The issues statement will be published and the main parties will have an opportunity to respond either in writing or at an oral hearing or (usually) both.

Annotated issues statement

The CMA will issue an "annotated issues statement" to the main parties in advance of the main party hearings, which indicates the CMA's current thinking on the issues. It will provide further information to that contained in the original issues statement and the parties will be provided with the opportunity to comment on it. The annotated issues statement will not be published.

Working papers

In advance of the main hearing, the CMA will send the main parties' working papers setting out its thinking on various matters, such as factual background and analysis relevant to the statutory questions, and inviting comments. These working papers contain the CMA's developing thinking on the issues and form the basis of the CMA's provisional findings (see further below), although they do not usually reach definitive conclusions (conclusions may be redacted). The parties are given the opportunity to respond to the working papers disclosed to them.

Hearings

Each of the main parties to the merger is asked to attend a hearing before the CMA towards the end of its assessment phase. The (usually separate) hearings with the main parties are usually preceded by hearings with some third parties, whose views on the merger the CMA will have sought either by advertisements in local and trade press, or by writing direct to those third parties which they have identified or which have submitted evidence. Third parties are invited to express their views in writing and some, usually those most likely to be affected by the merger, are invited to attend individual hearings with the CMA. The CMA will publish summaries of any hearings with third parties.

At the main party hearings, the party is given the opportunity to make brief opening and/or closing statements. The hearings give the parties an opportunity to answer the CMA's questions and develop the arguments set out in their written submissions. The hearings also give the CMA the opportunity to probe and test the parties' arguments and effectively to "cross examine" the main parties on the basis of comments received from third parties who have submitted evidence or attended their own hearings.

The CMA's questioning at the hearing will be detailed and searching, and will be directed to the representatives of the company (rather than its legal advisers) and the company's representatives will be expected to respond to the majority of the questions. It is therefore important that the relevant individuals make themselves available for the hearing and spend some time beforehand preparing themselves for the likely questions (identified on the basis of an agenda of topics for discussion which will be provided by the CMA shortly before the hearing).

There is usually an opportunity for the company's legal advisers and/or the company's representatives to make an opening or closing statement, if they wish. A transcript of the hearing is taken and subsequently made available to the relevant party for checking. The transcript is confidential between the party concerned and the CMA, as is the hearing.

Case team meetings

The CMA may also arrange meetings between the merging parties and the case team to discuss technical or analytical matters and responses to information requests. These meetings are less formal than the main parties' hearings.

6. Provisional, findings, remedies and decision

Provisional findings and remedies notice

The CMA is required to consult publicly and with the parties on its proposed findings. The provisional findings document is essentially its draft decision and it will be published (in non-confidential form) on the CMA's website. Extracts of the provisional findings document will be put back to the main parties and relevant third parties for checking for factual accuracy and to identify confidential information prior to publication on the CMA's website.

If the CMA concludes that the merger has resulted or can be expected to result in a SLC, then it must consider whether it or another body should take action – and, if so, what action – to remedy, mitigate or prevent the SLC or any resulting adverse effects, taking into account the need to ensure as comprehensive a solution as is reasonable and practicable. If this is the case, the CMA will issue a separate Notice of Possible Remedies setting out proposed remedies to any competition concerns which

have been provisionally identified and invite the parties' response. In proposing remedies, the CMA must take into account any customer benefits which the merger is expected to generate, and whether they impact on (or even remove the need for) the remedies.

The parties will be given a period of at least 21 days to comment on the provisional findings and a period of 14 days (and in any event no less than seven days) to comment on the remedies notice (if the CMA has provisionally considered that the merger is likely to have an anti-competitive outcome). Of course, if the provisional findings are in the parties' favour, no remedies need be discussed and a detailed response may not be required.

The CMA may invite the parties to attend a further oral hearing following receipt of their responses to the provisional findings. The CMA has stated that it will hold response hearings in cases where it has provisional competition concerns and where it is therefore necessary to discuss remedies.

Where a remedies notice has been published, following the response hearings, the CMA will send a remedies working paper to the main parties, containing a detailed assessment of the different remedies options and the CMA's provisional decision on remedies. A period of no less than five working days will be given for responding to the remedies working paper.

Final report

Once all submissions in response to the provisional findings, any remedies notice and remedies working paper have been considered, the CMA will finalise its report and announce its decision. The accompanying report will be published in non-confidential form. Remedies, if required, will be announced in outline only and the process of negotiating the detail will then commence.

Negotiation and implementation of remedies

The CMA has 12 weeks following publication of its final report within which to negotiate and finalise remedies or exercise its power to make an order for remedies (subject to a six week extension if there are special reasons for doing so). The remedies implemented must be consistent with the decision on remedies in the final report.

The CMA will create a new timetable for implementation of the remedies and will inform the main parties of the key dates. Once the remedies have been negotiated with the parties or ordered by the CMA, the CMA will publicly consult on the draft remedies, publishing a notice of intention to accept final undertakings (or intention to make an order) and seeking comments from third parties. The CMA must consult for a minimum period of 15 days in the case of undertakings and 30 days in the case of an order. If any material changes are required after consultation, a further minimum seven day consultation period is required.

The CMA will publish its notice of acceptance of undertakings or notice of making an order, at which point the inquiry is finally determined.

7. Powers to obtain evidence

The CMA has wide powers to require persons to attend to give evidence and to require a business undertaking to furnish estimates, returns and other information. These powers are backed up by the possibility of imposing fines (up to £30,000 for each failure to provide information and/or up to £15,000 per day of continued infringement) on a person who does not comply with an information request. Moreover, the intentional provision of false or misleading information or the intentional suppression, alteration or destruction of documents required to be produced constitutes a criminal offence for which a fine and/or imprisonment may be imposed.

In practice, the CMA expects, and normally receives, full co-operation from those involved in an inquiry. Information used to be typically requested on an informal basis, but the CMA is increasingly utilising its formal powers to require information from relevant parties and has imposed a number of financial penalties for incomplete and/or late responses to its information requests.

8. Restrictions on the parties during the inquiry

There is no requirement under UK merger control law that a merger must receive clearance before it may be completed. However, once a merger has been referred to Phase 2, the CMA has the power (either by making an interim order or accepting interim undertakings) to take any action to:

- prevent the transaction from being completed or pre-emptive action to integrate the businesses, in the case of anticipated mergers; or
- prevent further integration and/or unwind pre-emptive action to integrate the businesses, in the case of completed mergers. Where a merger has been completed already, in advance of the reference, there is an automatic prohibition on the parties taking any further steps to integrate the businesses without the prior permission of the CMA.

Following a reference to Phase 2, an automatic ban on share dealing will apply, such that no shares in the target business may be purchased by the purchaser without the CMA's permission.

Interim undertakings may be accepted by the CMA at Phase 2 where an interim order has not previously been made but some interim measures are considered necessary, or where it is necessary to supplement the measures previously put in place by an interim order made at Phase 1.

A monitoring trustee will normally be required by the CMA in order to monitor and report on compliance with the interim measures. Moreover, a hold separate manager with executive powers may be required by the CMA in order to operate the target business separately from the purchaser and in line with the interim measures for the duration of the investigation. Such interim measures will continue in force until final determination of the inquiry, unless ordered otherwise by the CMA.

9. Confidentiality

The CMA is under a general duty not to disclose business information obtained in the course of its investigation, with certain exceptions such as the need to properly explain its reasoning. In the case of its report, however, it is under a duty to have regard to the need for excluding from its report, so far as practicable, any matter that would or might in its opinion seriously and prejudicially affect the company's interests, unless in its opinion the inclusion of that matter is necessary for the purpose of the report. In practice, the CMA is usually prepared to respond to requests to exclude confidential commercial information from its report. If such information has to be included in the report, it is sometimes possible to persuade the Secretary of State to exclude it from the published copies of the report on the ground that publication would be against the public interest.

The parties receive putback papers containing excerpts of the CMA's reports and working papers and are provided with the opportunity to indicate confidential information which they wish to be redacted prior to publication by the CMA.

Hearings are conducted in private, and evidence given and submissions made by one party are not systematically disclosed to other parties or to third parties in the course of the reference. That said, the degree of transparency of inquiries is increasing and the CMA will tend to publish key submissions made by the main parties on its website. However, these will be non-confidential versions, with commercially sensitive information removed in consultation with the parties.

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If you would like further information on this guide, please speak to your usual contact at Ashurst or one of our contacts listed below.

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