

UK Merger Control Review:Q3 2017

Alistair Lindsay and Alison Berridge, Barristers, Monckton Chambers

In our latest quarterly review of UK merger control, we look in detail in the CMA's recent decisions in two hospital mergers, both cleared on the (extremely rare) basis of customer benefits. We also consider the new guidance on initial enforcement orders, as well as rounding up key developments in the period.

Efficiencies in merger control: double helpings

As is well known, efficiencies may be relevant in UK merger control either as a means of preventing a substantial lessening of competition (through increasing rivalry) or as a relevant customer benefit that might lead the CMA not to make a reference to phase 2 or affect the CMA's decision in phase 2 whether to impose a remedy and, if so, in what terms.

One of the curiosities of merger control is that mergers are treated more benignly than anti-competitive agreements because they are presumed to give rise to efficiencies, yet very few merging parties claim that their transaction will generate more than the (unspecified) presumed level of efficiencies, and those that do are generally rebuffed.

However, to set against that curiosity, in August 2017 two mergers between hospital providers that gave rise to SLCs were cleared on the basis of customer benefits. Central Manchester University Hospitals / University Hospital of South Manchester ("**Manchester Hospitals**") was cleared in phase 2 on 1 August 2017 even though the merger will combine two successful teaching hospitals and SLCs were found in 18 NHS elective and maternity services and in specialised services. University Hospitals Birmingham NHS FT / Heart of England NHS FT ("**Birmingham Hospitals**") was cleared in phase 1 on 30 August 2017 even though SLCs were found in 25 elective specialities, essentially because Heart of England FT ("**HERT**") had been underperforming and the merger would provide it with long-term access to the highly respected and skilled management from University Hospitals Birmingham ("**UHB**").

HSCA 2012, s. 79

The background to both cases is the Health and Social Care 2012, s. 79, which provides that the merger provisions in the Enterprise Act 2002 will apply "in so far as it would not otherwise be" the case to (i) mergers involving two or more NHS foundation trusts and (ii) mergers involving the activities of one or more NHS foundations trusts and one or more other businesses. Historically, such mergers had been considered by Monitor (which is now part of NHS Improvement). At around that time, the CMA took the view that mergers between foundation

trusts qualified in any event for review under the Enterprise Act 2002 (i.e. irrespective of the terms of the 2012 Act) and asserted jurisdiction over the [Poole / Bournemouth](#) deal. In broad terms, jurisdiction was transferred from Monitor to the CMA because competition, particularly as a result of patient choice, was at the time seen as an increasingly important driver of quality of care.

[SLCs despite a declining role for competition](#)

In [Manchester Hospitals](#) the CMA emphasised that the role of competition in delivering quality of care had declined. It pointed to the increased role of collaboration and collective responsibility in the provision of NHS services within local health economies and the increase in financial and capacity constraints. The CMA adopted this analysis in [Birmingham Hospitals](#).

Nevertheless, as already noted, the CMA found broad SLCs in both cases, covering many markets. In [Birmingham Hospitals](#), the CMA emphasised that it found an SLC on the basis of the “may be the case” test, rather than the balance of probabilities, which suggest that, had the case been referred to phase 2, it case might have been cleared unconditionally, irrespective of patient benefits. However, this analysis was driven not only by the observation that the role of competition has declined, but also by the relatively weak position of HERT prior to Monitor appointing the Chief Executive of UHB to be Interim Chief Executive of HEFT on 27 October 2015. Prior to this appointment, HEFT had been subject to unfavourable assessments by the CQC and Monitor. Essentially, if the merger did not proceed then UHB’s skilled management team which had helped to turn around HEFT on an interim basis would eventually withdraw and, in the absence of any other suitably skilled management team to take over, HEFT was likely to revert to its relatively weak position.

The facts of the [Manchester Hospitals](#) merger were rather different as the case involved a combination of two successful teaching hospitals. The CMA identified an SLC but emphasised that any adverse effects of that SLC were likely to be “significantly constrained” because of recent policy developments, devolution of health and social care in Greater Manchester, increased regulatory oversight, and local investment agreements that will make the provision of funding conditional on financial and quality targets. The CMA found that the adverse effects were “substantially lower” than the patient benefits and stated that this was “not a finely balanced conclusion”. The patient benefits included reduced mortality and reduced complications and morbidity (in particular by treating patients faster, reducing length of stay and improving patient pathways). The finding that those benefits substantially outweighed the adverse effects of the SLC implies that competition between the merging parties was not expected to deliver anything like equivalent benefits for patients.

Patient benefits

The patient benefits in the two cases were rather different. In Manchester Hospitals the benefits were focused on improvements in particular specialisms. By contrast, in Birmingham Hospitals the merger was seen as a way for HEFT to continue to benefit from the skilled management at UHB, and the CMA relied particularly on “hospital-wide ‘cross-cutting’ improvements” (as well as a set of benefits in particular clinical services). In balancing the SLC against the patient benefits, the CMA’s analysis was predominantly qualitative, although in Birmingham Hospitals the CMA observed that some of the benefits would benefit all HEFT patients (and in some cases all of the merged trust’s patients) whereas the SLCs concerned less than 15% of the parties’ total revenue from all services.

The evidence base

In both cases the CMA placed “significant weight” on the views of NHS Improvement. This is not surprising. Whilst the CMA is well placed to carry out elements of the benefits analysis (e.g. assessing timeliness), it lacks the clinical expertise to address other, central aspects, particularly the benefits of the merger in terms of reduced mortality and improved clinical outcomes including by reducing complications and morbidity. There was also strikingly strong support from other important stakeholders in both cases. In Manchester Hospitals, the merger also received strong support from commissioners in Greater Manchester and the Greater Manchester Health and Social Care Partnership. Similarly, the CQC and key commissioners supported the Birmingham Hospitals merger.

What are the implications for hospital mergers and other types of mergers?

The first question that arises from these two decisions is whether the CMA should retain its recently acquired central role in reviewing mergers between NHS foundation trusts? In both cases the CMA emphasised the declining importance of competition in influencing the quality of care delivered by foundation trusts and the evidence from NHS Improvement was of great significance. In those circumstances, there is a strong case to be made for amending the Health and Social Care Act 2012, s. 79 to transfer jurisdiction to review mergers between or involving NHS foundation trusts back to NHS Improvement (perhaps with the CMA providing advice to NHS Improvement on the competition analysis). The rationale for any change would be that the amount of time, effort and money involved the CMA review process appears disproportionate to the role that competition now plays.

The rather broader question is, where does this case leave efficiencies / customer benefits in merger control outside hospital mergers? Experience suggests that whenever cases of a particularly type succeed, they encourage emulators. Indeed, emulation might be desirable given that mergers are supposed to be about

the generation of efficiencies and customer benefits, and there is accordingly a strong analytical case for efficiencies / customer benefits to play a more central role in merger appraisal. However, it is not at all obvious that the Manchester Hospitals and Birmingham Hospitals cases herald a more sympathetic ear for efficiencies or customer benefits claims. There will not be many mergers where the benefits include reduced mortality and reduced complications and morbidity, nor mergers where the acquiring management team is encouraged by a regulator to take a “test drive” by taking over management of the target on an interim basis and where it can be shown that there are no other available management teams with comparable skill to the acquirer’s “stars”. Moreover, the finding of significant patient benefits was entirely unsurprising when seen against the evidence provided by key expert stakeholders, including NHS Improvement. Private merging parties will not enjoy support from equivalent neutral experts.

Other developments

The period provided plenty to interest merger control lawyers:

- the reference of Fox/Sky on both media plurality and broadcasting standards grounds;
- a new merger notice template designed to reduce the burdens on business;
- the appointment of Andrea Coscelli as Chief Executive of the CMA; and
- BIES’s consultation on an extension to the public interest intervention regime.

Initial enforcement orders – the art of standing still

Three years in, with its new regime fully embedded, the CMA has taken the opportunity to reflect on its use of initial enforcement orders and issue new guidance. The guidance seeks to provide greater clarity on derogations, encouraging parties to self-assess. There is also, for the very first time, guidance on information sharing for due diligence and the merger control process, something with clear application beyond IEO cases. Finally there are some signals that the CMA is ready to relax, very slightly, some of the “rules”, for example considering tailored IEOs in suitable cases.

The 2014 reforms

In a voluntary regime, the question arises how to prevent pre-emptive action and protect the CMA’s ability to impose effective remedies, especially in completed transactions. Prior to 2014 the CMA typically relied on voluntary undertakings, but these were sometimes time-consuming to negotiate, leaving the parties free

to integrate in the meantime. In 2014 the CMA adopted the practice of imposing a standard from order early in its investigation, inviting the parties to apply subsequently for derogations where the standard form did not deal well with the particular circumstances of their case.

The 2016 review

In March 2016 the CMA published a review of its practice in relation to initial enforcement orders. It concluded that:

- There was a lack of clarity regarding the actions that required a derogation from the standard form IEO;
- There was scope to reduce the response time to derogation requests; and
- The CMA should consider whether it was possible to be more targeted in its imposition of IEOs.

This reflected many of the frustrations felt in practice. The standard form IEO is not well adapted to every case – for example in fashion retailing the requirement to preserve the pre-merger range of goods would quickly lead to obsolescence. Yet the CMA is not always able to respond to derogation requests in the timescales demanded by the business and, as it itself notes, dealing with successive derogation requests can distract the case team and negatively impact the length of pre-notification.

From the CMA's perspective the burden of considering derogation requests appears to be increasing rapidly. The number of derogation requests dealt with rose from 47 in 2015/16 to 72 in 2016/17, an increase of over 50%. This was despite the CMA imposing slightly fewer IEOs in the 2016/17 period.

The 2017 Guidance

The new guidance is aimed primarily at improving clarity in relation to what actions require derogations, what derogations are likely to be granted, and encouraging merging parties to take a more streamlined and targeted approach to their requests. The CMA also indicated that it would consider its own procedure for responding to derogation requests and, within two years, the possibility of taking a more targeted approach to imposing IEOs.

The green list

The new guidance sets out a "green" list: derogations that are likely to be granted, subject to suitable justification and safeguards.

- **Provision of back-office support services to the target:** where these are not transferred with the target, and not available from the seller on a transitional basis, the CMA may permit the acquirer to provide support services to the target. A derogation is more likely where the services do not impact the commercial strategy of the target, such as IT, HR, accounting or legal services.
- **Integration of non-overlapping businesses and non-UK businesses:** where it is satisfied the ability to impose effective remedies is not compromised, the CMA may allow integration of non-overlapping businesses, sites or product lines, or activities outside the UK. It will be “particularly cautious” about granting such derogations at the early stages of its investigation, but these may be available as the investigation develops.

The CMA does not always halt integration on a worldwide basis: the template IEO states that it will cover non-UK activities “to the extent appropriate” (the guidance does not expand on this enigmatic phrase).¹ Where it does, this often causes frustration, and the above acknowledgement that the IEO scope can taper off as the investigation progresses is therefore a welcome development.

- **Transfer of staff to the target business:** the guidance contemplates that the acquirer may be permitted to transfer staff to the target business only in very restricted circumstances: where the target’s own staff have left, where there are no other staff within the target or externally available who able to carry out the role, and subject to cutting all contact with the acquirer business.

The red list

The guidance also lists categories of derogation that are unlikely to be granted:

- Assuming control over the commercial policy of the target business;
- The taking over of sales, bidding or negotiating functions of the target;
- Entering into or amending commercial agreements between the parties;
- Joint dealing with customers or suppliers; and
- Closure of overlapping business functions.

The guidance does however indicate that this is not an absolute rule. The CMA

¹ Jurisdictionally, the CMA is only able to restrict the actions of companies incorporated in or carrying on business in the UK, but this is nevertheless a wide scope.

will take into account the need to safeguard the viability of the target business, and this may justify derogations in the above categories, subject to appropriate safeguards.

Information flows

Perhaps the most interesting section of the new guidance deals with the sharing of confidential information between the merging parties.

Under the standard form IEO, all such sharing is prohibited unless “strictly necessary” in the ordinary course of business, and protected by certain procedural safeguards. The new guidance clarifies that integration planning, due diligence and the merger control process itself are all ordinary course activities, and so can provide a justification for sharing sensitive information. The guidance goes on to be relatively specific about the safeguards the CMA will expect, outlining what practitioners will recognise as a clean team arrangement.

While this is strictly guidance on the interpretation of the standard form IEO, it is tempting to read it also as applying to Chapter I / Article 101. All merger practitioners spend time advising on how to manage these essential deal processes lawfully, but they do so without the benefit of formal guidance and under increasing scrutiny from enforcement agencies worldwide. When navigating hostile territory without a map, even sketchy directions are welcome.²

A footnote suggests that the CMA may wish to review the wording of clean team agreements. Publishing the results of such reviews would allow the CMA to provide further clarity on this key issue.

A very slightly more flexible use of IEOs

While the CMA has postponed its consideration of a more targeted approach to imposing IEOs, the guidance signals that it may already be willing to take a - very slightly - more flexible approach:

- **Completed mergers:** as the CMA has previously stated,³ it will “normally” expect to impose an IEO in completed mergers. The new guidance clarifies the circumstances in which an exception might be made, such as when other regulation makes pre-emptive action impracticable, or where the transaction self-evidently raises no competition concerns.
- **Tailored IEOs:** while the CMA will continue to rely on its standard form IEO, it will consider a “tailored” form where this is likely to optimise procedural

² The effect is slightly undermined by 3.43(e), suggesting that the CMA will in most cases decline to permit any sharing of sensitive information.

³ CMA2

efficiency (by minimising derogation requests) and minimise disruption to the parties' businesses.

Timing and process

The CMA confirms its practice of making an IEO as soon as possible after the merger comes to its attention, but revoking it at a relatively early stage (typically the internal state of play meeting) where it forms the provisional conclusion that the merger does not give rise to competition concerns.

The new guidance reminds merging parties to make their derogations requests early, and ideally in a single consolidated application. A template application is provided. It stops short, however, of setting a target response period for the CMA's decision on derogation applications.

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