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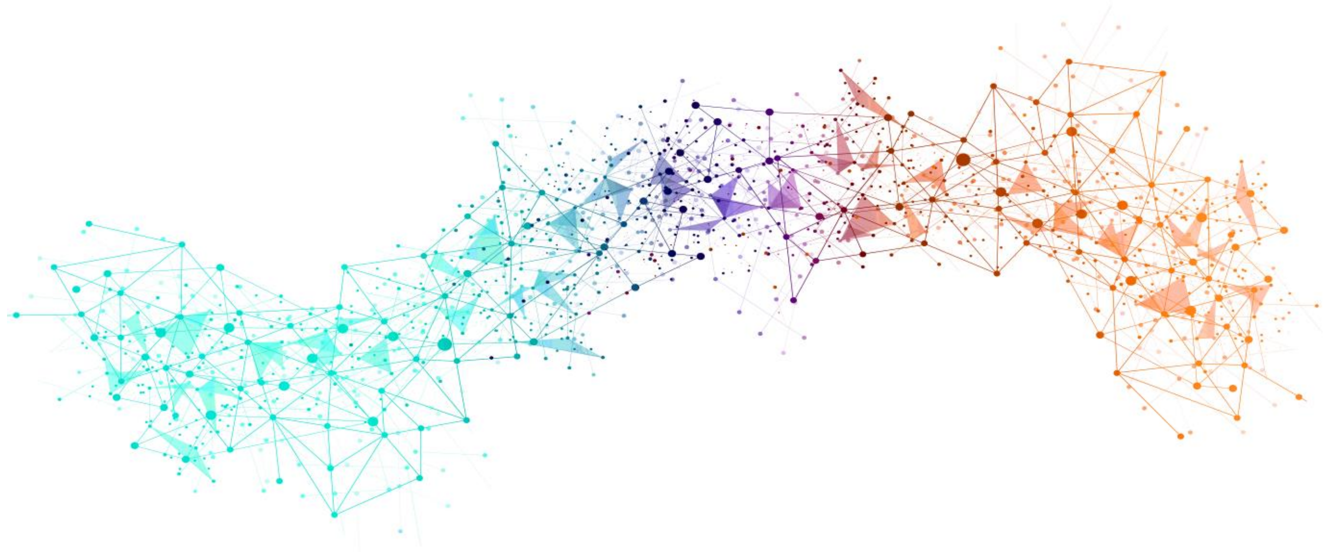

UK merger control : CMA sets out its approach to assessing mergers in an increasingly dynamic and digital world

A decade after the UK antitrust authorities last issued guidelines on how deals are substantively analysed under the UK merger control regime, and as the end of the Brexit transition period approaches, the UK Competition and Markets Authority (**CMA**) has launched a consultation on updated guidance.

Updated guidance is all the more critical in the context of the CMA's current tough stance on merger control. Enforcement is at record-breaking levels: 2019 saw eight deals frustrated (ie prohibited or abandoned due to antitrust concerns) in the UK – nearly three times higher than the previous year – and 2020 will top that with four prohibitions and five transactions abandoned already.

The guidance comes at a time when the merger assessment of both the CMA and the European Commission (**Commission**) has suffered court set back. In the case of the CMA, this month the Competition Appeal Tribunal (**CAT**) quashed its JD Sports/Footasylum final report in so far as its conclusions were based on the CMA's assessment of the likely effects of the Covid-19 pandemic on the relevant markets, the merging parties/merged entity, and the competitive constraints likely to apply to the merging parties/merged entity. While generally endorsing the CMA's approach to assessing the effects of the merger, the CAT considered that the CMA's approach to gathering information about the specific impact of the pandemic (relevant to its assessment of the counterfactual) was irrational. (The CMA is considering whether to appeal.) In the case of the Commission, in May the EU's General Court upheld CK Hutchison's appeal against the Commission's 2016 prohibition of its proposed acquisition of Telefónica UK, which would have brought together two of the UK's four mobile network operators. Our alert sets out how the judgment has made it harder for the

Commission to block transactions that fall short of creating or strengthening a dominant player, even where the market is already relatively concentrated. (The Commission has appealed the ruling.) A clarification of the CMA's approach to the application of the "substantial lessening of competition" (**SLC**) test is an important step as the end of the Brexit transition period approaches, leaving the UK with a fully standalone merger control regime.

The draft revised merger assessment guidelines also provide invaluable insight into how the CMA approaches its assessment of digital mergers. Unsurprisingly, a large number of digital-related expert reports – including the Furman report and the Lear report – have fed into the updates. But a number of the changes are of broader application, reflecting recent CMA cases, case law and the experience of other antitrust authorities around the world.

In summary, these are the key policy themes which have been refreshed, clarified and in some cases modified: (i) non-price competitive factors are granted greater prominence; (ii) the CMA highlights its wide margin of discretion in gathering and use of evidence, and is not deterred by a degree of uncertainty; (iii) the counter-factual is given a make-over; (iv) the test of closeness of competition (the issue that proved fatal to the Commission's Hutchison/ Telefónica UK decision) is clarified; (v) a spotlight is shone on two-sided markets and potential competition; (vi) vertical mergers remain firmly on the CMA's radar; (vii) the CMA is sceptical about merger efficiencies; and (viii) the CMA will take a flexible approach defining the market.

References in square brackets below are to paragraph/footnote numbers in the draft revised guidelines.

NON-PRICE COMPETITIVE FACTORS ARE GRANTED GREATER PROMINENCE

The revised guidelines place a far greater focus on the importance of non-price aspects of competition (including innovation, and quality and range of products), noting that the fact that customers do not pay a monetary price for a good/service does not preclude competitive effects from arising [2.4]. The CMA mentions privacy levels, brand reputation, product sustainability and advert-free content [2.5].

THE CMA HIGHLIGHTS ITS WIDE MARGIN OF DISCRETION IN GATHERING AND USE OF EVIDENCE, AND IS NOT DETERRED BY A DEGREE OF UNCERTAINTY

The revised guidelines clarify the CMA's broad degree of freedom in its use and interpretation of evidence. It also details how that interpretation will evolve over time and may be affected by the context in which the evidence is generated. For example, the CMA notes that it may attach **more evidentiary weight to internal documents generated prior to contemplation or awareness of a merger**, that it may not attach weight to evidence that a merged entity has not changed its behaviour post-completion and that it will not necessarily be deterred by a lack of evidence of efforts or explicit entry or expansion plans to rule out a firm organically entering a market absent the merger [2.28]. More generally, the CMA confirms what we have seen in practice: an increasing interrogation of the merger firms' internal documents and close scrutiny of the evidence on deal valuation [2.23]. And the CMA confirms that "there is no set hierarchy between quantitative evidence", and it will not normally quantify the SLC [2.24].

This section of the revised guidelines also homes in on nascent and dynamic, inherently uncertain markets, where the types of evidence available to the CMA may be more restricted, noting that the CMA "may place particular weight on evidence such as internal documents, the expected number of competitors after the merger, similarities between the characteristics of the products or services that are under development, and the views and expansion plans of market participants" [2.27]. The CMA is adamant that "the presence of some uncertainty will not in itself preclude the CMA from concluding that the SLC test is met on the basis of all the available evidence" [2.26].

THE COUNTERFACTUAL GETS A MAKE-OVER

The proposed changes to guidance on the assessment of the counterfactual (what the competitive market conditions would be without the merger) are significant

and reflect the CMA's move to more dynamic assessments:

- the CMA clarifies that complexity and uncertainty about the future will not mean in themselves that the CMA will assume the pre-merger situation to be the appropriate counterfactual. The CMA may consider the ability and incentive (including evidence of intention) of the merging parties to pursue alternatives to the merger, potentially including a review of available evidence on specific plans [3.14].
- the CMA acknowledges that the **time horizon** for counterfactuals will depend on the market context, and that "relevant developments may not take place for some years". It notes that successful entry in digital markets can take longer than two years, but that the time horizon over which a firm may exit the market could be significantly shorter [3.15].
- the CMA has narrowed the **exiting firm test** with the removal of the third element (that considers the redistribution of sales among remaining market players) so that the CMA may in future accept the defence if: (i) the firm in question would likely have exited (through failure or otherwise); and (ii) there would not have been an alternative, less anti-competitive purchaser for the firm or its assets to the acquirer in question [3.22]. The CMA justifies the change in its consultation document by saying that in practice it has applied the test less mechanistically than the current guidance suggests. No doubt this will encourage parties to raise the defence in mergers involving pandemic-stricken players.

CLARIFICATION OF THE TEST OF CLOSENESS OF COMPETITION

The revised guidelines reflect the CMA's view that closeness of competition between merger firms in differentiated markets increases the likelihood of unilateral effects because the merged entity will recapture a more significant share of the sales lost in response to a price increase (or another worsening in the offering), making the price rise more profitable. The CMA may have concerns even where the firms are not each other's closest rivals. "It is sufficient that the merger firms compete closely and that the remaining competitive constraints are not sufficient to offset the loss of competition between them" [4.7]. And the parties' products/services do not have to have similar characteristics where, for example, a disruptive 'maverick' exerts a strong constraint on other firms [4.8]. Significantly, the CMA notes that merger firms may exert asymmetric constraints on each other "such that one merger firm may be a close competitive constraint on the other, without the reverse being the case" [4.10]. The CMA provides an example: large supermarkets may be a good alternative for customers of convenience stores, while convenience stores may be a poor alternative for customers of large supermarkets (fn 76].

A SPOT-LIGHT ON TWO-SIDED MARKETS . . .

A substantial expansion of the guidance on 'two-sided' markets (and by extension 'multi-sided' markets) outlines factors the CMA will take into account when reviewing mergers involving two-sided platforms, and how network effects and the risk of tipping may influence the CMA's assessment. Notably, the CMA retains some flexibility: "the CMA may consider each side of the platform separately, or it may consider the overall competition between the platforms (incorporating both sides in one assessment)" [4.23].

. . . AS WELL AS POTENTIAL (INCLUDING FUTURE) COMPETITION

The revised guidelines clarify that potential competition may be eliminated where:

- a merger involves a potential entrant and there is therefore a **loss of the future competition** between the merger firms after the potential entrant would have entered or expanded [5.2]. The CMA notes that "where one merger firm has a strong position in the market, even small increments in market power may give rise to competition concerns and, therefore, the acquisition by any such firm of a potential entrant may be concerning even if its impact on competition is uncertain, or expected to be small" [5.15]. The CMA will consider whether, for example, the potential entrant is planning to introduce a disruptive new business model or technology, or might be able to benefit from

existing customer relationships from related products to gain scale quickly [5.16]; and

- existing and potential competitors interact in an ongoing dynamic competitive process (perhaps via investments in innovation that may then lead to entry or expansion, or which might mitigate the loss of future profits to potential entrants) and a merger could lead to a **loss of this dynamic competition** [5.3]. Here the CMA singles out digital platforms and pharmaceutical mergers to exemplify its point. For example, the CMA notes that it may consider a broader loss of competition arising from a reduction in the merger firms' incentives to continue investing in competing strategies, rather than focusing on individual future overlaps, where "two digital platforms exhibiting a pattern of using their existing platforms or suites of integrated services as a launchpad to enter into new, overlapping services" [5.21]

VERTICAL MERGERS REMAIN FIRMLY ON THE CMA'S RADAR

Non-horizontal mergers are not off the hook. The CMA has "frequently investigated vertical mergers, and in several cases found that these give rise to competition concerns" and notes that "a number of commentators continue to warn of the substantial risks of under-enforcement against vertical mergers" [7.6]. The revised guidance on vertical and conglomerate effects is substantial. In relation to input foreclosure, the CMA has reframed the factors that it considers capture a merged entity's ability to foreclose rivals to: (i) a merged entity's market power upstream; and (ii) the importance of the input in framing downstream competition. It also states that its assessment "is unlikely to place material weight on contractual protections, for example, to continue supplying both the current version and future upgrades of the input. In practice, such contracts may not completely remove a firm's ability to harm its rivals, given that certain rivals might not be covered by these contracts, the contracts might not protect all ways in which the competitiveness of rivals could be harmed, and the contracts may be of limited duration. Moreover, over time contracts may be renegotiated or terminated, and firms may waive their rights to enforce any breaches in light of their overall bargaining position (reflecting the change in market structure brought about by a merger)" [7.14]. The CMA will, however, consider the impact of any financial or reputational costs of terminating contracts on foreclosure incentives.

CMA IS SCEPTICAL ABOUT MERGER EFFICIENCIES

The draft guidelines note that the CMA's experience has been that it is rare for countervailing measures (such as entry or expansion by a rival or the expected realisation of a merger efficiency) to be the primary reason for a merger clearance [8.1]. Again, it states that its "experience to date is that it is unusual to find merger-specific efficiencies that would benefit consumers and rare for a merger to be cleared on the basis of efficiencies" [8.6]. Nevertheless, the CMA is open to the fact that in some instances mergers can give rise to efficiencies [8.2]. It categorises these as "rivalry-enhancing efficiencies" (changing the incentives of the merger firms to induce them to act as stronger competitors to their rivals) and "relevant customer benefits" (merger-specific customer benefits other than through improved market competition, such as reduced carbon emissions (to the extent firms do not normally compete on sustainability)). Significantly, relevant customer benefits can be taken into account even if they are expected to be realised in markets other than the one subject to an SLC finding [8.20] and where they benefit society more generally [8.19]. The burden of proof falls on the merger firms, and any evidence supporting such claims should be provided early in the review process [8.7].

FLEXIBILITY IN DEFINING THE MARKET

The revised guidelines also reflect the CMA's view that market definition is merely a potentially useful tool and "not an end in itself" [9.4]. There is an assertion that the CMA's assessment of competitive effects does not need to be based on a highly specific description of any particular market definition (including, for example, descriptions of the precise boundaries of the relevant markets and bright-line determinations of whether particular products or services fall within the relevant market). In future, the CMA may take a more simple approach to defining the market – for example, "by describing the market as comprising the most important constraints on the merger firms that have been identified in the CMA's assessment of competitive effects" [9.5]. Overall the revised guidelines build in more flexibility on the relevance, and the CMA's use of, market definition.

THE SHORT ROAD AHEAD TO A FULLY STANDALONE MERGER CONTROL REGIME

The CMA's consultation on the guidelines runs until 8 January 2021. Timing for a final version is not clear, but we expect the CMA to prioritise formalisation of the updates, together with its ongoing consultations on revised drafts of its jurisdiction and procedure guidelines and mergers intelligence function guidance. We look at the latest evidence on the CMA's tough approach to merger control in this alert.

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