Competition & Markets Authority

A Quick Guide to UK Merger Assessment

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CMA18

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This publication is also available at: www.gov.uk/cma.

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1 INTRODUCTION

1.1 Mergers can bring benefits to the economy and help businesses and markets grow. Many are pro-competitive or have a benign effect on competition. However, some can harm competition and result in, for example, higher prices, reduced quality or choice for consumers, or reduced innovation. The aim of merger review is to ensure that mergers do not substantially lessen competition and lead to worse outcomes for consumers, for example, through higher prices, lower quality or reduced choice.

1.2 This quick guide provides a simple overview of the merger regime in the UK and the approach of the Competition and Markets Authority (CMA) when reviewing mergers. The CMA took over this merger review function on 1 April 2014, in place of the Office of Fair Trading (OFT) and the Competition Commission (CC).

1.3 The CMA has:

- published more detailed guidance on the circumstances in which the CMA may review a merger, and its procedures for doing so (*Mergers: Guidance on the CMA's approach to jurisdiction and procedure* (CMA2)), and

- adopted guidance, jointly published by the OFT and CC, on the economic assessment of mergers (*Merger Assessment Guidelines* (OFT1254/CC2 (Revised)).

That guidance takes precedence in the event of any inconsistency with this guide.

2 MERGER REVIEW IN THE UK

Who is responsible for UK merger review?

2.1 Merger review in the UK is primarily the responsibility of the CMA, which is an independent public authority. In exceptional cases the Secretary of State may intervene if the merger affects national security, media plurality, or the stability of the financial system.

2.2 The European Commission (EC) examines mergers of businesses with EU and global turnover above a certain size, including those that may have an impact in the UK. Mergers that have their main impact in the UK can be transferred to the CMA for examination, and some mergers that do not meet the EC's thresholds may nonetheless be transferred to it by the merging businesses or the CMA.

What mergers may the CMA review?

2.3 The CMA has the jurisdiction to examine a merger (which includes acquisitions and joint ventures) where:

- two or more enterprises cease to be distinct
- and
  - either the UK turnover of the acquired enterprise exceeds £70 million
  - or the two enterprises supply or acquire at least 25 per cent of the same goods or services supplied in the UK (or a substantial part of it) and the merger increases that share of supply.

2.4 The term 'enterprise' may include whole businesses or parts of businesses, whether or not they operate for profit. Two enterprises cease to be distinct if they are brought under common ownership or control. This includes situations falling short of outright voting control, such as where one enterprise controls or has material influence over the policy of the other, even though it does not hold the majority of the voting rights in that other enterprise.

2.5 Further information is available in *Mergers: Guidance on the CMA's approach to jurisdiction and procedure* (CMA2).

How may the CMA come to review a merger?

2.6 There are two routes by which the CMA may come to review a merger:

- **Notification.** Businesses can formally notify a merger to the CMA by completing a Merger Notice. A template Merger Notice, available at www.gov.uk/cma, sets out the categories of information required by the CMA, together with guidance notes to assist businesses in identifying the specific nature and extent of information required in their case. Before submitting a Merger Notice, businesses are strongly encouraged to approach the CMA to discuss their merger (and any drafts of the businesses' completed Merger Notice) on a confidential basis. Such pre-notification discussions can help to reduce the amount of information that the CMA needs from the business, and can occur before a merger is public knowledge. Businesses cannot formally submit a Merger Notice until the merger has been made public.

- **CMA own-initiative investigation.** The CMA has a responsibility to keep merger activity under review and can investigate mergers that have not been notified to it. The CMA obtains information about anticipated and completed mergers from a range of sources, including from third parties. Where the CMA learns of a merger that it thinks might harm competition, the CMA can open an investigation on its own initiative. The CMA may contact the businesses in order to establish whether the thresholds that trigger its jurisdiction are met and to obtain information about the merger.

How long does the CMA's merger review take?

2.7 The CMA has a statutory deadline of 40 working days in which to complete the initial stage of its merger review process (Phase 1). That statutory period starts on the first working day after the CMA confirms (a) that it has received a satisfactory Merger Notice, containing the information it requires for its review, or (b) in the case of an investigation started on the CMA's initiative, that it has received sufficient information to enable it to begin its investigation. The CMA may 'stop the clock' in certain circumstances, in particular where information the CMA has formally requested remains outstanding.

2.8 At Phase 1, the CMA determines whether it believes that the merger results in a realistic prospect of a substantial lessening of competition (SLC). If so, the CMA has a duty to launch an in-depth assessment (Phase 2), although merging parties may offer to modify aspects of the transaction to 'remedy'

any competition concerns identified (known as Undertakings In Lieu (UILs)), thereby obtaining a resolution at Phase 1, conditional on acceptance of the remedies (see **Does the CMA always launch a Phase 2 investigation into a problematic merger?** below).

2.9 At Phase 2, generally limited to 24 weeks, a CMA panel of independent Members conducts an in-depth investigation to assess if a merger is expected to result in an SLC. If an SLC is expected, the CMA decides upon the remedies required. Such remedies may include prohibiting the merger or requiring the divestiture (sale) of parts of the business (see **What remedies can the CMA apply at Phase 2?** below). Having issued a final report in which it has decided that a merger gives rise to an SLC, the CMA has a statutory deadline of 12 weeks (extendable by up to six weeks for special reasons) to make an order or accept undertakings to give effect to its Phase 2 remedies.

Do businesses have to pay a fee for the CMA's merger review?

2.10 Yes, a fee is payable by the notifying business for the CMA's review, subject to some limited exceptions (including where the merger is found to be outside the CMA's jurisdiction). The obligation to pay a fee is the same whether the merger is notified by the businesses or reviewed by the CMA on its own initiative.

Do businesses have to tell the CMA that they are merging?

2.11 No. Although businesses often choose to do so, there is no requirement that businesses seek the CMA's approval before merging, even where the CMA would have jurisdiction to review the merger (see **What mergers may the CMA review?** above).

Why do businesses decide to tell the CMA they are merging?

2.12 Approval before merging benefits businesses by giving legal certainty that the merger can proceed. In addition, there may be risks for businesses if they do not do so.

2.13 Not telling the CMA about a merger does not mean that it cannot or will not review it. As explained above, the CMA has a responsibility to keep merger activity under review and may investigate, on its own initiative, mergers that have not been notified. The CMA has four months from the merger being made public or it being completed (whichever is the later) to decide whether or not to launch an in-depth Phase 2 assessment.

2.14 Completing a merger without notifying the CMA before doing so can also result in significant additional costs for businesses:

- First, the CMA has powers to impose restrictions (known as interim measures) on businesses to prevent them taking actions (for example, integration of the merging businesses) that might pre-empt the CMA's exercise of its merger review powers. For instance, the CMA can appoint a trustee to monitor these measures at the businesses' expense.
- Second, costs can arise from having to dispose of the merged business if the merger is prohibited (see **What remedies can the CMA apply at Phase 2?** below).
- Third, in the case of completed mergers that have not been notified, the period of time that the CMA has to consider the merger at Phase 1 may be constrained, given the four month statutory deadline described above. This may limit the opportunity to obtain evidence that may support clearing the merger without the need for a Phase 2 investigation.

2.15 In light of the above, businesses should consider carefully whether to tell the CMA about their merger before completing. In particular, businesses are strongly encouraged to do so where the merger could give rise to possible competition concerns. As a guide, over the last five years around 30 to 40 per cent of the total number of Phase 1 cases, and around 25 to 30 per cent of Phase 1 cases where an SLC has been found, have been 'own-initiative' investigations rather than mergers that were notified.

Does the CMA always launch a Phase 2 investigation into a problematic merger?

2.16 If the CMA believes that the merger results in a realistic prospect of an SLC it has a duty to launch a more detailed Phase 2 assessment.

2.17 However, the CMA may decide not to launch a Phase 2 investigation where the merging businesses have, within 5 working days of receiving the CMA's reasons for its decision that there is a realistic prospect of an SLC, offered UILs (mainly offers to sell businesses or assets) that remedy in a clear cut manner the SLC that the CMA believes may occur.

- Although UILs are offered formally by businesses only once the CMA has given its reasons for its decision that there is a realistic prospect of an SLC, this does not prevent businesses considering, and discussing with the CMA, possible UILs before then. Throughout the course of its investigation, including during pre-notification discussions, the CMA will

seek to give the businesses guidance on UILs they are considering. The fact that a business wants to discuss possible UILs with the CMA will not increase the likelihood that the CMA will decide there is a realistic prospect of an SLC.

- The CMA may decide that the UILs offered by a merging business must include a commitment that, before the CMA formally accepts the undertakings, the merging business will enter into a sale agreement with an ‘upfront buyer’ for the business or assets that it is offering to sell. Businesses should consider this when deciding what to include in any offer of UILs at Phase 1.

2.18 The CMA also has the discretion not to launch a Phase 2 investigation if it believes that:

- the market is not of sufficient importance to justify a Phase 2 investigation
- there are benefits to customers arising from the merger that outweigh the effect of the SLC (see also *Efficiencies* below), or
- the anticipated merger is not sufficiently advanced or likely to proceed to justify a Phase 2 investigation.

2.19 Further information is available in *Mergers: Guidance on the CMA’s approach to jurisdiction and procedure* (CMA2) and *Mergers—Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122).

How does a Phase 2 review differ from a Phase 1 review?

2.20 The CMA is required to consider both at Phase 1 and at Phase 2 whether there is a relevant merger situation (see **What mergers can the CMA review?** above) and if so, whether it will result in an SLC. Although the CMA is responsible for both Phase 1 and Phase 2, to ensure a transparent and distinct process the decision makers at Phase 2, comprising of a panel of independent Members, are different to the decision maker at Phase 1.

2.21 The CMA uses the same overall analytical approach in Phase 1 and Phase 2 when assessing the potential effects of a merger on competition. However, the CMA applies different thresholds as to the likelihood of a Substantial Lessening of Competition at each phase. At Phase 1, the CMA considers whether there is a 'realistic prospect' of an SLC; at Phase 2, the CMA decides whether the merger is more likely than not to lead to an SLC (that is, on the ‘balance of probabilities’). The different thresholds, and the need for

the CMA to reach a definitive view at Phase 2, mean the Phase 2 investigation and analysis are deeper and broader.

2.22 Phase 2 is the final phase of the CMA's investigation and so the actions that it may take at the end of that Phase are different from those at the end of Phase 1 (as described in **Does the CMA always launch a Phase 2 investigation into a problematic merger?** above). If the CMA finds after its Phase 2 investigation that the merger is not expected to result in an SLC, no further action is taken. But if the CMA finds at Phase 2 that a merger is expected to result in an SLC, it will decide what action should be taken to remedy, mitigate, or prevent that SLC, and can impose remedies by order if it is not able to agree them with the businesses (see **What remedies can the CMA apply at Phase 2?** below).

3 MERGER ASSESSMENT

What is a substantial lessening of competition (SLC)?

3.1 Competition is the process of rivalry over time between businesses seeking to win customers' business by offering them a better deal. An SLC occurs when rivalry is substantially less intense after the merger than would otherwise have been the case, resulting in a worse outcome for customers (through, for example, higher prices, reduced quality or reduced choice).

How does the CMA determine whether there is an SLC?

A Identifying the relevant markets

3.2 In examining whether an SLC is likely to occur, the CMA needs to identify the market that is relevant to the merger. Identifying the relevant market involves an element of judgment.

3.3 What the relevant market contains depends on the type of merger:

- when one business acquires a rival (a horizontal merger) the relevant market contains the overlapping products of the merging businesses
- when a business acquires another operating at a different level in the distribution chain (a vertical merger) the relevant markets are those for the products in the same chain
- when a business acquires another that supplies different products that its customers also buy (as in a conglomerate merger) the relevant markets are those for the products sold to those customers.

3.4 As well as containing the products supplied by the merging businesses, the relevant markets may also contain the most significant competing products available to their customers.

3.5 Nonetheless, when assessing a merger the CMA may take into account ways in which some products—inside the relevant market or outside it—compete with the merging businesses' products more significantly than others.

3.6 The same approach is applied to markets for the provision of services.

Market shares

3.7 As part of its assessment of the merger, the CMA may consider market shares. If so, the CMA will seek to define what the relevant market is on which these shares are calculated. This relevant market will represent a technical market and may differ from what businesses refer to as the market that they operate in, but this approach makes sure that market shares provide useful information.

3.8 Market shares can give an indication of the potential extent of a firm’s market power. The combined market shares of the merging businesses, when compared with their respective pre-merger market shares, can provide an indication of the change in market power resulting from the merger.

B Examining the effects on competition

Unilateral effects

3.9 One way a horizontal merger can harm competition is if it removes an important competitor, allowing the merged business profitably to raise prices. This is known as a ‘unilateral effect’ and is the effect that the CMA considers most frequently.

3.10 Unilateral effects are more likely if:

- the merging businesses’ products are close substitutes and the variable profit margins of those products are high
- customers have little choice of alternative supplier, for example because the costs to them of switching from one to another are high
- it is difficult for rival businesses to respond to price increases, for example because they have no spare production capacity
- the merger eliminates an important competitive force in the market, for example a business with a novel commercial model
- there are already few significant businesses in the market or if the merger results in a business with a large market share.

Coordinated effects

3.11 A horizontal merger may also lessen competition by enabling or encouraging post-merger coordinated interaction amongst businesses in the market that harms customers.

3.12 Coordination may arise when businesses operating in the same market recognise that they can reach a more profitable outcome if they limit the extent to which they compete against each other.

3.13 Such coordination need not be explicit (collusion) but might emerge through implicit understandings and can take a number of forms. Businesses may be able to keep prices higher than they would otherwise be, if there is an implicit understanding between those businesses that they will not compete strongly against each other, for example, by dividing the market(s) up between them or allocating contracts amongst themselves in bidding competitions. For coordination to be effective:

- businesses need to be able to reach a common understanding and monitor compliance with such an understanding
- businesses must have the incentive to stick to the coordinated outcome, and
- there must be little chance of such an understanding being disrupted by other factors, such as entry or expansion by other businesses.

Vertical and conglomerate mergers

3.14 Mergers are not always between rivals. Vertical and conglomerate mergers bring products together that do not themselves compete but may be related. In general, vertical and conglomerate mergers are less likely than horizontal mergers to give rise to an SLC. In a vertical merger, the merging businesses may benefit from efficiencies that give them a greater incentive to compete (and therefore, for example, to lower prices).

3.15 Nevertheless, vertical mergers may occasionally damage competition if the merged business restricts downstream competitors' access to a key input or restricts upstream competitors from a key 'route to market'.

3.16 Conglomerate mergers may occasionally damage competition if the merged business can employ selling practices that link the products in the separate markets together (for example, through bundling the separate products).

3.17 These harmful effects of vertical or conglomerate mergers on competition will only arise if the merged business would have the ability and incentive to act this way, such a strategy results in harm to competition, and such harm outweighs any beneficial effects on competition through efficiencies achieved by the merger.

C Assessing countervailing factors

3.18 The CMA will also consider any factors that might prevent or significantly reduce any harmful impact of the merger. There are three main factors — efficiencies, entry and expansion in the market, and countervailing buyer power.

Efficiencies

3.19 While mergers can harm competition, they can also give rise to efficiencies that make the merged business a more effective competitor. If these merger-specific efficiencies are large and timely enough, they can enhance rivalry and prevent a merger giving rise to an SLC. Efficiencies that do not enhance rivalry can also be taken into account as benefits to customers, provided that they are likely to arise within a reasonable period. However, claimed efficiencies and customer benefits can be hard for the CMA to verify because most of the information is held by the merging businesses. As a result, for the CMA to give weight to efficiency arguments, it must have compelling evidence that such efficiencies not only result directly from the merger itself, but also that they will be timely, likely and sufficient to prevent an SLC from arising.

Entry and expansion

3.20 In some cases, entry by other businesses or expansion by businesses already in the market may be expected to be timely enough and sufficient to reduce any harmful impact of the merger.

3.21 However, there may be barriers to entry or expansion in the market. These barriers may be absolute, for example a patent; structural, for example economies of scale; or strategic, for example the advantage of being the first mover or pioneer in a market.

Countervailing buyer power

3.22 A customer has countervailing buyer power when it has the negotiating strength to limit a business's ability to raise prices. An SLC is less likely to

occur where all customers have countervailing buyer power post-merger than where only some customers do. A customer's negotiating strength is greater if it can easily switch its demand away from the merged business.

How does the CMA decide which factors to assess?

3.23 The CMA focuses early in its inquiries on what factors might mean that the merger leads to an SLC. These factors are written down as hypotheses, known as 'theories of harm'. They aid the inquiry by narrowing down the issues that have to be addressed, reducing the information that has to be gathered and minimising the risk that the CMA will pursue unproductive lines of inquiry. Theories of harm are kept under review, may not be the same at Phase 2 as at Phase 1, and may be revised as the inquiry develops to maintain the inquiry's focus on the relevant factors likely to lead to an SLC.

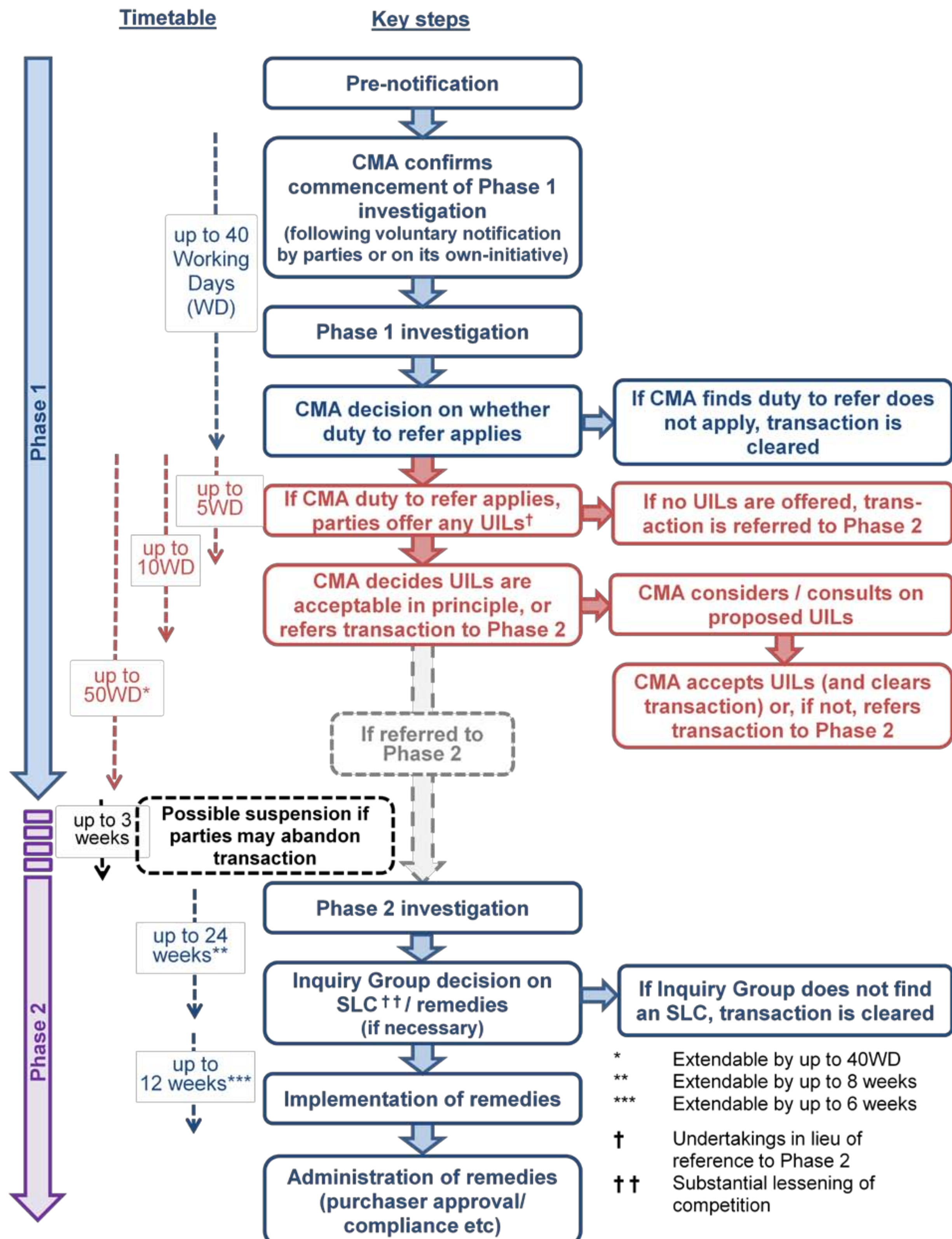
4 REMEDIES

What remedies can the CMA apply at Phase 2?

4.1 If, following a Phase 2 assessment, the CMA decides that a merger gives rise to an SLC, it will take steps to remedy the effects. For an anticipated merger, this will often mean that the merger is prohibited, although it could be allowed to proceed subject to suitable conditions, for example a divestiture (sale) of part of the business to be acquired. For a completed merger, the CMA will normally seek to divest all or part of the acquired business to a suitable purchaser who can provide effective competition. Undertakings as to future behaviour may be accepted in addition to, or occasionally instead of, divestiture.

4.2 Further information is available in *Merger Remedies: Competition Commission Guidelines* (CC8).

5 PRINCIPAL STAGES OF A CMA MERGER INVESTIGATION



6 FURTHER INFORMATION

CMA publications

Mergers: Guidance on the CMA's approach to jurisdiction and procedure (CMA2)

Administrative penalties: Statement of Policy on the CMA's approach (CMA4)

Merger Notice for use by business for notifying an anticipated or completed merger to the CMA under Section 96 of the Enterprise Act 2002 (as amended)

OFT/CC publications adopted by the CMA

Merger assessment guidelines (CC2(revised)/OFT1254)

Mergers—Exceptions to the duty to refer and undertakings in lieu of reference guidance (OFT1122)

Merger Remedies: Competition Commission Guidelines (CC8)

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