Linklaters

Response to CMA Call for Information on Digital Mergers

1 Introduction

1.1 Linklaters LLP ("**Linklaters**") welcomes the opportunity to contribute to the CMA's Call for Information on Digital Mergers (the "**Call for Information**"). We support the CMA's initiative to update and supplement the Merger Assessment Guidelines ("**Guidelines**"), noting that this corresponds to Recommended Action 9 of the Furman Report.

1.2 We have a number of comments informed by practical experience in UK Phase II cases such as Just Eat/Hungryhouse (online food platforms) and Ticketmaster/Live Nation (online live event ticketing platforms), as a Phase I decision-maker, and in many other UK and EC cases where the counterfactual, potential competition or innovation were pivotal issues.

1.3 As this Call for Information has a narrow focus on the Guidelines, we do not make broader conceptual comments on the digital merger debate covered in the Lear, Furman, Cremer and Stigler reports et al, with which the CMA will be very familiar. The bottom line, however, is that, however ideal a revision of the Guidelines may be, they cannot solve issues of uncertainty, nor the tension in the CMA's policy position in proposing to stretch the regime and push its legal boundaries, but not to propose a legislative consultation to change the test (i.e. adopting the Lear recommendation to take risks while rejecting Furman report Recommendation 10).[1] These are fundamental public policy issues that call for consultation.

1.4 With these caveats in mind, we have a number of suggestions for revision to the Guidelines set out below. We would be happy to discuss them further and elaborate if that would be useful.

2 Comments

A. The Guidelines need a comprehensive update to be made useful

2.1 First, we strongly endorse the proposal in the Call for Information to update the Guidelines more generally including "*aspects not connected to the assessment of digital mergers*" (5.2). That said, we are not immediately sure that there many such discrete aspects of the Guidelines that should be thought of as "unconnected" to digital M&A and look forward to further engagement on this issue.

2.2 More generally, we think it would be wholly unwise and a missed opportunity to update the Guidelines with a digital-only supplement. The Guidelines are generally out of date and are not representative of the weight of decisional practice from 2010-19. They demand a substantial overhaul if they are to be useful in practice. In practice, we refer to CMA

[1] See Lear, *Ex post Assessment of Merger Control Decisions in Digital Markets*, May 2019 (Lear report), para. I.161-163 and Report of the Digital Competition Expert Panel, *Unlocking Digital Competition*, March 2019, (Furman report) paras. 3.95ff. The Lear Report highlights gaps in past UK merger analysis from which welcome lessons will no doubt be drawn. What is most telling, however, is that unlike in the "killer acquisitions" empirical studies of certain pharmaceutical sector cases, we note that even Lear was unable in any of its digital merger case studies to reach an ex post conclusion that, in its view, a given transaction was overall anti-competitive in hindsight, after weighing efficiencies and adverse effects. At the same time, it recommends stretching the time horizon on predictive counterfactuals ex ante. If Lear cannot reach a finding that a transaction was more likely than not anticompetitive with the benefit of hindsight, it is difficult to see how, on the same facts, any authority would reliably be able to do so on a predictive basis.

procedural guidance daily but for substantive guidance we rely on our own CMA case experience and published decisional practice – and not the Guidelines.

2.3 For example, in the vast majority of cases from 2010-19, the prime theory of harm has been horizontal unilateral effects in differentiated market settings and, in applying that theory, the outcome in Phase I has largely turned on whether the merging parties are or are not characterised as (sufficiently) "close" competitors (and not, for example, on entry, expansion, repositioning, efficiencies or buyer power). Closeness of competition and horizontal unilateral effects theories (which capture "dominance") will self-evidently remain key in digital M&A analysis. Yet the Guidelines provide at best scant guidance on what defines "close", on dynamic issues of closeness (e.g. repositioning, which could encompass monetising a user base built up through a free service), or on how to measure "closeness" and incentives (e.g. diversion ratios, GUPPI, win/loss) etc. It would be a major contribution of revised Guidelines if "closeness" as a concept had some depth and some limiting principles, and if they could move the regime beyond a "black box" to a principled approach to safe harbour/screening thresholds (or, more rarely, intervention thresholds).

B. Generalisations of 'digital' vs. 'non-digital' must be mindful of the need for clarity of definition and conceptual coherence

2.4 Second, we are sceptical of rigid lines between digital and non-digital. For example, we fail immediately to see that existing theories of harm in the Guidelines should in future only apply to non-digital or only apply to digital; the same applies to countervailing constraints, and efficiencies.

2.5 Careful thought should be given to coherence between merger control applied to digital setting and non-digital ones. As a first step, the Guidelines should define what, in the CMA's mind, a digital merger is, and be mindful of the binary fallacy in characterising markets or players as 100% digital or 100% non-digital. Once that is clear, coherence can fully account for differentiating factors, such as the importance of network effects, inter-operability of platforms, data issues, and so forth. But the differences should be rational, easy to understand and predictable.

2.6 To tease this out, the Guidelines should therefore not have a separate digital supplement but discuss the proposed differential treatment of digital under the relevant conceptual heading of the Guidelines. In rejecting the "balance of harms" test proposed by the Furman report, the CMA was sensitive to unintended consequences in applying a different legal test to digital vs. non-digital mergers. The same point applies to the Guidelines.

C. Issues of evidentiary weight are often decisive and not limited to 'digital'

2.7 Third, issues of evidentiary weight are not generally addressed in the Guidelines but would be welcome content – as weighing of evidence is where the real action in UK merger control tends to lie. However, coherence dictates that discussion of these issues not be limited to digital settings but should cover these points generally – and explain relevant differences the CMA may propose between digital and non-digital.

Internal documents

2.8 For example, the weight to attach to internal documents is an issue in no way limited to digital. We suggest principles of evidentiary weight be based on general quality control principles not specific to digital M&A, such as: (i) the author and her or his seniority and decision-making credentials; (ii) the formality or otherwise of the context; (iii) the audience; (iv) whether the document is "ordinary course" or not; (v) whether the relevant statement is

ambiguous; (vi) whether the inference from the statement is corroborated by other internal documents and is part of a pattern or is a one-off or outliner or contradicted elsewhere; and (vii) whether the inference is corroborated by non-documentary evidence or not. Equally, while advocacy by merging parties should be quality-controlled for consistency with internal documents, the same should apply even-handedly to those with opposing incentives e.g. competitor advocacy.[2]

Consumer switching preferences

2.9 As is evident from US practice, revealed consumer preferences (e.g. diversion ratios based on actual consumer switching) should be accorded more weight, all else equal, than stated consumer preferences (answers to hypothetical questions about diversion behaviour); again, this is not a digital issue.

Deal valuation

2.10 While interrogating deal valuation makes eminent sense to sense check whether the drivers are (i) enterprise value plus pro-competitive efficiencies or (ii) involve a market power premium, this should be best practice more broadly (and requires dispassionate engagement with efficiencies).

D. The Guidelines should systematically move 'closeness of competition' beyond a business-model similarities checklist

2.11 Fourth, the issue that the closest competitor to one merging party might be a (disruptive) player with a very different business model, not a very similar or cookie-cutter/me-too model, is highly pertinent. In the case of Just Eat/Hungryhouse, the CMA ultimately accepted at Phase II that Deliveroo and Uber Eats (with their differentiated and innovative business models) were the most potent competitive threats to Just Eat, and not Hungryhouse despite the "2 to 1" theory based on the similarity in the merging parties' business models.

2.12 In LoveFilm/Amazon, the importance of the weight of overall documentary evidence, rather than selecting one or two documents in isolation, was important to the conclusion that LoveFilm would be constrained post-merger by players with very different business models, notwithstanding the merger was a "2 to 1" of the business model in question.

2.13 However, the reverse could be true: an acquisition of a player with a different business model may raise competition issues that a standard CMA checklist approach on "closeness" (business model similarities) would miss. Almost by definition, a disrupter will have a different business model to the incumbents. Accordingly, a checklist approach can tend towards false negative errors as well as false positive ones.

2.14 While coordinated effects analysis has moved beyond the checklist approach prior to Airtours v. Commission, new draft Guidelines would do well to ensure that the same applies to unilateral effects in differentiated markets, and to ensure that a focus on supply-side similarities does not detract from proper focus on demand-side preferences and dynamic competition, including from disrupters.

---

2 Gaming by rivals prompted relevant commentary in the OFT's jurisdictional and procedural guidance (adopted in CMA J&P Guidance para. 6.12).

E. Network effects

2.15 Fifth, on the importance of network effects, this is common ground and has been well ventilated. With respect to indirect network effects, our experience was this "chicken and egg" problem for the non-incumbent was insufficiently understood by the CC in Ticketmaster/Live Nation in the relevant digital platform context. However, the more recent experience in Just East/Hungryhouse was that network effects were properly diagnosed in assessing the negligible competitive constraint that the distant #2 platform, Hungryhouse, exerted on the #1, Just Eat (who, as noted, was instead constrained from disrupters, Deliveroo and Uber Eats).

F. Error cost analysis and substantiality

2.16 Sixth, on the issue of uncertainty and the legal test, we note that the OFT used explicit "balance of harms"-style error cost analysis at Phase I in its BSkyB/ITV report to the Secretary of State, given the uncertain nature of developments and the size of the consumer market. However, this was only possible under the Phase I legal test (and not the Phase II test). The CMA also appears to employ error cost thinking, albeit somewhat less explicitly, in SSE/npower at Phase I with reference to household energy bills. Error cost also animates the approach to Phase I de minimis inherited and updated by the CMA.

2.17 To the extent the CMA proposes to use error cost analysis in Phase II without changing the legal test, the draft Guidelines for consultation should explicitly address this subject and, in particular, address the "substantiality" of SLC assessment employed by the CMA in Sainsbury's/Asda in connection with markets of "importance" to consumer households, and in particular low-income households. These issues are acutely relevant to any large consumer or retail market – including the most often-discussed digital consumer-facing markets – and demand a coherent approach.

G. Counterfactuals involving alternative acquirers

2.18 Seventh, we note that in BSkyB/ITV (where a rival Virgin Media bid for ITV had been mooted in the press) and Tesco/Kwik Save, on the issue of counterfactuals involving alternative acquirers, the OFT set out general cautions and concerns it had about the "beauty contest" unworkability of comparing a deal before the OFT with a deal not before the OFT, as well as issues of system gaming.

2.19 In preparing the draft Guidelines for consultation, the CMA might consider whether it agrees or not with this approach in general, for digital, or under what circumstances.

H. Use of limiting principles in potential competition scenarios

2.20 Finally, we note that in airline mergers, it can always be speculated that any airline with (ready access to) relevant slot pairs could be a potential entrant on any given route that it does not currently operate. For this reason, in Air France-KLM/City Jet, the OFT set out limiting principles on theories of harm involving potential competition corresponding also to limiting principles applied by the EC in airline mergers.

2.21 In preparing the draft Guidelines for consultation, the CMA might consider whether these limiting principles are valid generally and whether to draw any distinctions it proposes are required with respect to digital mergers.

July 2019