Call for information on digital mergers

This note provides a response to the CMA's Call for Information on digital mergers.[1] The views in this paper are my own.[2]

Potential competition

Currently, The CMA's Merger Assessment Guidelines (MAGs) describe two ways in which mergers may lead to an important loss of potential competition – "There are two ways in which the removal of a potential entrant could lessen competition by weakening the competitive constraint on an incumbent supplier".[3]

The first is called 'actual potential' competition and arises "where the merger involves a potential entrant that could have increased competition. Such 'actual potential competition' is a constraint only if and when entry occurs".[4]

The second is called 'perceived potential competition'. It arises when a firm is not in the market but the threat of entry, as perceived by the incumbents, prevents the incumbents from increasing their prices. The CMA notes that this form of competitive constraint may arise even though the CMA does not believe that entry would actually occur.

'Actual potential competition' seems to indicate a scenario in which entry is currently contemplated, by one of the merging firms, into a market where the other merging firm is currently operating. Therefore, it is expected that these two firms will compete in future in a market where one of them is currently competing.

As currently drafted, 'actual potential competition', may not reflect another potential way in which harm to potential future competition may arise. This additional scenario is not one in which the incumbents (including one of the merging firms) are currently constrained by the threat of entry of the other merging firm, whether the threat of entry is actual or perceived. Rather, this is a scenario in which entry may take place by both firms into markets where neither firm is currently operating. Although this may be captured currently in the MAGs, they could clarify this further and point to cases in which such concerns have been explored.

Recommendation:

- The CMA should update the MAGs to reflect more clearly that they capture scenarios where overlaps may arise in markets in which neither of the merging parties currently operates.
- More generally, the CMA should ensure consistency throughout the MAGs by indicating that concerns about potential competition are a standard part of merger assessment and that this includes assessing the likelihood of overlaps in products, services or markets where there are not currently overlaps.[5]

[1] https://www.gov.uk/government/consultations/call-for-information-digital-mergers

[2] Contact: [redacted]

[3] See paragraph 5.4.14 and following of MAGs. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

[4] The CMA says that questions it would consider include: (a) Would the potential entrant be likely to enter in the absence of the merger? (b) Would such entry lead to greater competition? The Authorities will also consider whether there are other potential entrants before reaching a conclusion on the SLC test.

[5] For example, this might be reflected at paragraph 4.1.15.

This appears to be a theory of harm which the CMA has considered on a number of occasions in previous mergers.[6] This indicates that the potential concern may arise in a variety of sectors, not just technology. Nevertheless, it may be in technology sectors where this concern is most likely to be pertinent. This may be because technology markets are particularly prone to changes in offerings over a relatively short period. Therefore, even if two firms are not currently competing, they may (absent a merger) become important competitors to each other within a number of years as technology and customer preferences evolve.

One particular challenge that may arise is the ability of the CMA to identify where exactly the overlap may arise in future. For example, in *The Gym/Pure Gym*, the Phase I decision considered that the merging parties may overlap in geographical areas in future, but that it may not be possible to identify all of those areas. Similarly, in *VTech/Leapfrog*, there was a potential concern that the merging parties may overlap with certain toys in future, but it may not be possible to identify on which toys exactly they may overlap. One may expect these types of challenges to be exacerbated in digital technology sectors.

In assessing theories of harm related to potential competition, the CMA relies heavily on internal documents of the merging parties. It is likely that key evidence in assessing 'actual potential competition' will be found in the internal documents of the merging parties. These documents may be expected to be probative of future entry and expansion plans and the competitive threats faced following such entry and expansion.

Similarly, when assessing the likelihood and impact of entry and expansion from competitors to the merging parties, the CMA is likely to rely on the views and internal documents of competitors. The MAGs could provide more clarity on the evidence that is likely to be useful in assessing concerns about 'actual potential competition'. This may be important for the CMA to indicate to the courts the special reliance that is likely to be placed on internal documents in such merger assessments.

Moreover, it may also be important to signal to competitors of the merging parties that the CMA is likely to seek their views, and perhaps also internal documents, on their own entry and expansion plans. Competitors are likely to see these views and documents as highly confidential and may not wish to share these with the CMA.[7] Highlighting the importance of these in the MAGs may strengthen the CMA's position in demanding internal documents from competitors and explaining why these are necessary.

There are also a number of practical difficulties that the CMA faces in operationalising a more intensive assessment of 'actual potential competition' in a greater number of mergers. There will also be challenges in reviewing a large volume of documents from the merging parties and from potential competitors. There are significant challenges in the CMA's 'put back' process in Phase II mergers, which deals with accuracy, confidentiality and redactions. It is not clear that this burdensome process is fit for purpose if the CMA is to explore concerns about potential competition in more depth and more frequently. At the same time, the CMA is likely to face greater legal and procedural

[6] For example, the CMA has considered this type of theory of harm, whether in relation to entry into product/service markets or new geographic markets, in *The Gym/Pure Gym, VTech/Leapfrog* (at Phase I), *Menzies/Airline Services*, *Paypal/iZettle*, and currently in *Illumina/PacBio*.

[7] The CMA already requests views and internal documents from alternative purchasers of the target, particularly when considering the counterfactual. However, detailed requests for internal documents may go well beyond alternative purchasers of the target, to competitors and potential competitors of the merging parties, when assessing 'actual potential competition'.

challenges from the merging parties about their ability to defend the merger if they are unable to see all the available evidence, including the future plans of competitors.

Moreover, the evidence that may be gleaned from internal documents may be of a somewhat different nature to the type of evidence which may arise when assessing existing overlaps. When assessing potential competition, there may be no mention, in the internal documents of one firm, of the other firm; or if there is, it is not identified as a competitive threat. Rather, the competition authority may need to look at additional sources of evidence, such as:

- the similarity of the business models of the two firms, relative to other providers;
- the future strategies, product developments, and geographical target areas of the firms to consider whether they are likely to overlap in future;
- what the acquirer has done previously with assets its has previously acquired in similar industries;
- a history of copy-cat behaviour on product innovations, or cross-licensing of technologies, in the sector;
- the price being paid by the acquirer and what justifies this price.

It may be that the development of artificial intelligence, or decentralised ledger technology, or other technological developments, provide a threat to incumbent technology companies in the many activities in which they are engaged and in how they monetise them. The likelihood of an overlap will necessarily be uncertain, perhaps highly uncertain. Nevertheless, it may be from unexpected sources where the greatest challenge to incumbents is likely to come. Concerns about potential competition are necessarily going to be more speculative than those based on current overlaps, and will need to be weighed against the potential of the merger to lead to complementarities and innovations which would not otherwise take place.

Given the recent experience of the CMA in exploring potential competition, and the recent focus on how this may be assessed, the CMA could provide greater guidance on when such concerns are more likely to arise and what types of evidence are likely to be probative.

Recommendation:

- The CMA should highlight the key sources of evidence in assessing potential competition, particularly the role of internal documents of the merging parties and potential competitors;
- The CMA should consider how to tackle the practical challenges it faces in operationalising more in-depth and/or more frequent analyses of potential competition.
- The CMA should develop further the guidance provided currently at paragraph 5.4.15 in the light of the CMA's recent experience and thinking. The guidance should seek to identify evidence that is consistent with concerns about potential competition and how the CMA would consider alternative inferences from this evidence.
- Concerns about potential competition might arise in any industry. However, the MAGs might also explain that certain types of industries – particularly those where product/service innovation is a strong trait and which are prone to having small numbers of players and high levels of concentration – have characteristics which are consistent with concerns about potential competition.

The MAGs note (at paragraph 5.4.15) that, in assessing whether a merger leads to unilateral effects from a loss of 'actual potential competition', the CMA will consider (i)

the likelihood of entry in the absence of the merger; (ii) would such entry lead to greater competition; and (iii) potential entry by competitors.

The MAGs may benefit from some small amendments in their explanation of the analytical framework. First, it could indicate that he CMA will consider both entry and expansion of the merging parties in the absence of the merger.

Second, the CMA could explain more about how the framework applies to potential entry by competitors to the merging parties, and how this would apply in practice. The MAGs currently refer the reader to Section 5.8 of the guidelines, where barriers to entry and expansion are discussed. There is merit in including some of the concepts explained in the barriers to entry and expansion section in the discussion of the framework for 'actual potential competition'. While this risks repetition, it should also provide greater clarity in an area of merger assessment which is particularly complex and has seen evolving practice.

In particular, the CMA should highlight that it will consider whether entry and expansion by other potential competitors would be timely, likely and sufficient, taking into account the capabilities and incentives of these players, to prevent any realistic prospect of an SLC that would otherwise arise due to the merger.

The CMA might also provide greater clarity on whether the 'timely, likely and sufficient' standard effectively applies also to the assessment of the likelihood and closeness of competition between the merging parties. One might expect the CMA to take a symmetric approach for both the merging parties and competitors in assessing the likelihood and closeness of competition. On the other hand, concerns have been raised about underenforcement of merger control in the area of digital technologies and it may be easier to build up an understanding of the internal documents and strategies of the merging parties rather than their competitors. This may justify weighing more heavily evidence of the likelihood of future overlaps between the merging parties than evidence of the likelihood of entry by rivals, at least at Phase I. Either way, more clarity could be provided on whether the assessment of the merging parties and competitors is the same or somehow different.

Recommendation:

- The CMA should amend the MAGs to indicate the role of 'expansion' in assessing 'actual potential competition';
- The CMA should explain in the 'Potential Competition' section of the MAGs, how it applies the 'timely, likely and sufficient' framework for potential entry and expansion from competitors, and clarify how its approach differs, if at all, in the assessment of the merging parties;

Jurisdiction

There are two tests for jurisdiction. First, the 'turnover test' is satisfied where the annual value of the UK turnover of the enterprise being acquired exceeds £70 million. Second, the 'share of supply test' is satisfied if the merging enterprises: (i) supply or acquire goods or services of a particular description; and (ii) will after the merger collectively supply or acquire 25 per cent or more of those goods or services, in the UK as a whole or in a substantial part of it, provided that the merger results in an increment to that share.

This implies that the CMA will not have jurisdiction over the merger when there is no increment and the turnover of the target is below £70 million in the UK.
This could mean that the CMA would not have jurisdiction in those scenarios where the merging parties do not currently overlap but may do so in the future, as discussed earlier. It may also mean that the CMA does not have jurisdiction in vertical and

conglomerate mergers for which the value of turnover for the enterprise being acquired is below £70 million.[8]

The CMA has a fairly broad discretion in how to apply the 'share of supply' test, and has applied it in imaginative ways. It has also allowed itself to review the substance of mergers alongside its assessment of jurisdiction, such that it may delay coming to a conclusion on whether the 'share of supply' test is met until it has decided on whether or not there is an SLC. Nevertheless, the CMA continues to face some challenges in seeking to review mergers due to the rules on jurisdiction. In addition, while the broadness and flexibility of the share of supply test will often allow the CMA to claim jurisdiction, it also means that there is a lack of certainty for merging parties when assessing whether to make a UK merger filing. This places an additional burden on the Merger Intelligence Committee in identifying potential anticompetitive mergers. It may also create unnecessary uncertainty for businesses when seeking to complete a merger, while facing the possibility of the CMA 'calling in' the merger following completion.

There are many merits to the UK's voluntary notification regime and its rules for jurisdiction. Nevertheless, the different practices around the world, and the uniqueness of the UK position, indicate that there are many valid approaches. There may be merit in the CMA publicly exploring the relative merits of alternative approaches alongside its re-assessment of the MAGs. Additionally, or alternatively, the CMA could provide further guidance (whether formal or informal) on how it may interpret the share of supply test in the context of mergers in the technology sector.[9] For example, the CMA might make it clear that it would consider an increment in the share of supply as including scenarios of future overlaps in markets where one or both of the merging firms do not currently operate. The CMA might also explore how it would assess overlaps in product markets where the nature of the future product is uncertain.

Counterfactual

The application of the SLC test involves a comparison of the prospects for competition following the merger against the competitive situation without the merger. The latter is called the 'counterfactual'.[10]

The MAGs explain that, in the Phase I assessment, the effect of the merger is compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. Therefore, the Phase I counterfactual is not required to be the most likely counterfactual, but is required to be realistic. While the Phase I counterfactual is usually the prevailing conditions of competition, it may alternatively be a more competitive counterfactual than prevailing conditions.[11] This alternative counterfactual does not need to be the most likely counterfactual to arise in the absence of the merger. This appears to accord with the requirement at Phase I to assess whether there is a 'realistic prospect' of an SLC.[12]

In the Phase II assessment, the counterfactual may also be more competitive than the prevailing conditions of competition. However, the Phase II counterfactual is not necessarily the most competitive counterfactual. Although several possible future

[8] This may be a particular issue in technology mergers where firms may have very low turnovers for a number of years, but yet be seen as providing an innovative and valuable product/service.

[9] For example, the share of supply test could be changed to look explicitly at overlaps within an eco-system. So, if the acquiring firm could potentially make use of the acquisition somewhere within its eco-system, this should count as an overlap for qualification purposes.

[10] MAGs, paragraph 4.3.1.

[11] MAGs, paragraph 4.3.5.

[12] MAGs, paragraph 4.3.5.

scenarios may be considered at Phase II, ultimately only the most likely scenario will be selected as the counterfactual.[13] This appears to accord with the requirement on the Phase II assessment to apply a 'balance of probabilities' threshold to its analysis. At Phase II, the CMA must answer whether it is more likely than not (ie with an expectation of there being more than a 50 per cent chance) that an SLC will result from the merger. This is a higher level of probability than that required to make an SLC finding at Phase I.[14]

The CMA will generally seek to do most of the analytical 'heavy lifting' in its assessment of the likely effects of the merger, while seeking to keep the counterfactual simple. This is a sensible and effective approach. Nevertheless, the CMA may find itself considering mergers where, in a given market, (i) there is a current overlap and the merger is assessed against prevailing conditions of competition; and (ii) there is a potential stronger overlap in future, due to one or both merging parties investing heavily in expansion, and the merger needs also to be assessed against this alternative counterfactual. This appears to necessitate considering multiple counterfactuals. Moreover, as explained further below, in assessing future overlaps, there may be more than one reasonable alternative counterfactual against which the merger could be assessed.

The Furman review has called for the "a more economic approach to assessing mergers [which] would be to weigh up both the likelihood and the magnitude of the impact of the merger. This would mean mergers being blocked when they are expected to do more harm than good. The Panel calls this a 'balance of harms' approach".[15] "The balance of harms test would have similarities with the government's recognised approach for making regulatory decisions, which draws on the principles of cost-benefit analysis. This can combine qualitative and quantitative analysis and judgements, with various techniques for addressing the challenges of uncertainty. This approach is frequently used for significant and complex government decisions, for example for public health proposals, environmental protection, or major infrastructure investment.[16]
The Furman review also notes that a range of sources have supported an approach along these lines, including The Centre for Competition Policy, which proposed in response to the panel's call for evidence that: "it would be wise to amend the standard 'more likely than not' merger test to allow greater harms, which are at least "realistic prospects", to weigh more heavily in the merger decision".[17]

The CMA will need to give careful thought to how the recommendation of the Furman review could be operationalised and whether this can be achieved while maintaining a single counterfactual in the Phase II assessment. It is hard to understand how the Phase II process can effectively consider different realistic prospects and assign likely levels of competitive harm to these different prospects without simultaneously entertaining a number of counterfactuals.

For example, in the context of 'actual potential competition', these counterfactuals might include the following, with different likelihoods attached to each: (i) the acquirer entering into a new market and the target also entering into a new market through its own investments; (ii) the acquirer entering into a new market and the target entering with a strong likelihood if it was instead purchased by alternative purchaser X; (iii) the acquirer entering into a new market and the target entering with a weaker likelihood if it was

[13] MAGs, paragraph 4.3.6.
[14] MAGs, paragraph 2.12.
[15] 'Unlocking Digital Competition', Report of the Digital Competition Expert Panel, March 2019, (Furman review), paragraph 3.88
[16] Furman review, footnote 18.
[17] Furman review, paragraph 3.90.

instead purchased by alternative purchaser Y; (iv) one or both of the acquirer and target not entering the same new market.

If we presume here that the CMA will keep a number of counterfactuals under consideration and not necessarily conclude which is the most likely, then it can apply weight to each indicating the level of competitive harm. For example, the most likely counterfactual may lead to a merger for which there is no SLC (say, the target was unlikely to enter a new market independently in the absence of the merger), but a slightly less likely counterfactual may lead to an SLC with a high level of consumer detriment (say, the target was likely to enter a new market if purchased by the most likely alternative purchaser). The Furman review suggests that a cost-benefit type of analysis is used to evaluate in aggregate the likely outcome of the merger across these different possibilities. It is not clear how the Furman recommendation would work while maintaining a single counterfactual at Phase II.

Recommendation:

- The CMA should clarify whether it is necessary to choose a single counterfactual in the Phase II process and, if not, clarify how it would consider multiple counterfactuals.
- The CMA should explain whether, and how, the implementation of 'recommended action 10' of the Furman review can be implemented without maintaining multiple counterfactuals.

The ability to assess the substance of a merger prior to opening an investigation

In the following, I describe briefly some of the processes of the CMA's Merger Intelligence Committee, before exploring alternatives to the current approach.

The CMA's Mergers Intelligence Committee monitors markets and can 'call in' any case which has not been notified to it and over which it has jurisdiction. The CMA has explained that it will take a decision to investigate if it believes that there is a reasonable chance that the test for a reference to an in-depth Phase 2 investigation will be met. The threshold for the CMA to open an investigation is therefore lower than the threshold for reference.[18]

If the CMA decides to investigate, then it must publish an invitation to comment. In addition, once the CMA has decided to investigate, it is required to publish a reasoned decision setting out why it has decided to make a reference or decided not to make a reference. Neither the duty to publish an invitation to comment nor the duty to publish a reasoned decision applies while the CMA is still deciding whether to investigate.[19]

Where the CMA has identified a transaction that may qualify for investigation (ie there is a reasonable chance that an investigation will identify a relevant merger situation) and raises potential concerns, it may ask parties to provide information to help it determine whether to open an investigation.[20] Requests to main parties will usually relate to the turnover and share of supply tests set.[21]

If the CMA determines that further information is required after asking these questions, then it will take a decision to investigate. Except in dealing with a party to a transaction

[18] Paragraph 2, Guidance on the CMA's mergers intelligence function, 5 September 2017.
[19] Paragraph 3, Guidance on the CMA's mergers intelligence function, 5 September 2017.
[20] Paragraph 6, Guidance on the CMA's mergers intelligence function, 5 September 2017.
[21] Paragraph 7, Guidance on the CMA's mergers intelligence function, 5 September 2017.

who has contacted the CMA, or dealing with a third party which has submitted a complaint, the CMA will not ask questions relating to whether the transaction may give rise to a substantial lessening of competition without first taking a decision to investigate.[22]

Main parties are welcome to submit a short briefing note (maximum five pages) to the CMA, explaining why they do not propose to submit or have not submitted a Merger Notice to the CMA. The note may address both whether there may be a relevant merger situation and whether it may give rise to a substantial lessening of competition.[23]

In summary, the foregoing implies that, unless the merging parties contact the CMA with a Merger Notification or a briefing paper, the CMA can only seek information (from the merging parties or third parties) relating to whether the merger lessens competition by opening a formal investigation.[24] Any investigation opened must provide reasons for the decision whether to refer or not. These decisions are appealable and also have precedent value. Therefore, each merger investigation opened has substantial fixed costs in terms of the resources which the CMA must invest – there are rarely short cuts, even for mergers which may quickly (but following the opening of an investigation) appear highly unlikely to raise competition concerns.

If the CMA is to give greater consideration to mergers in the digital technology sector than it has before, then this will require substantially more resources. Nevertheless, it is widely-recognised that the large majority of mergers in this area are likely to be competitively neutral or benign. Therefore, there is a balance to be met between providing greater scrutiny and using up valuable resources investigating mergers which are unlikely to be problematic.

One way of achieving this balance is allowing the CMA greater flexibility in exploring the competitive assessment of a merger with the merging parties and third parties prior to opening a merger investigation. This would allow, but not require, the CMA to pose questions to the merging parties which go beyond issues of jurisdiction and whether there is a relevant merger situation. This could be based on the CMA's review of publicly available information on the merger or in response to a briefing paper sent to the CMA. The CMA might also have greater liberty to explore the likely competitive effects of the merger with competitors and/or customers, in some limited fashion, prior to opening a formal investigation.[25] While this would likely require greater resources to be expended by the Mergers Intelligence Committee, it would save on the greater resources that would be expended on opening investigations which quickly proved not to be of concern. This would allow the CMA to review the likely competitive impact, in a light touch way, of a greater number of mergers, without incurring the substantial resource costs of opening formal investigations into all of them.

Recommendation:

- The CMA should explore ways in which it can understand more about the likelihood of a merger giving rise to an SLC before it opens a formal investigation.

[22] Paragraph 9, Guidance on the CMA's mergers intelligence function, 5 September 2017.

[23] Paragraph 11, Guidance on the CMA's mergers intelligence function, 5 September 2017.

[24] Exceptions may be made in relation to communications with sectoral regulators and government departments. However, competitors and customers will not be contacted in the absence of a notified merger, unless they have already made a complaint.

[25] For example, the CMA might simply ask competitors or customers to say whether they have any concerns about the merger and to explain these.

Market features

The Call for information on digital markets asks what are the market features which are likely to be relevant to the assessment of mergers in digital markets.

It is clear that the multi-sided nature of platforms is likely to be relevant. The multi-sided nature of markets means that there are likely to be indirect network externalities. These externalities may lead to markets becoming more concentrated (including the potential for the market to tip to a small number of providers) and harder for new entrants to establish themselves and expand.

There may also be important differences between the behaviour of different market participants in terms of single-homing or multi-homing across different platforms and this may, in turn, create significant differences in the incentives and ability of one or both sides of the market to switch providers. For example, switching digital platforms may require some coordination between the different sides of the market.

The CMA already has substantial recent experience of assessing digital mergers in multi-sided markets (for example, JustEat / Hungry House). In addition, the features of digital markets described above have been discussed extensively in available literature. Some of this literature also provides practical advice on how to incorporate these features into the analysis - for example, the OECD has published such materials.[26]

There is merit in considering how the MAGs might reflect the suggestions in this literature for adapting merger assessment to the circumstances of digital mergers. In addition, the CMA could consider setting out the types of data which are likely to be useful in assessing mergers in digital platform markets (for example, information on the extent of single-homing and multi-homing and what inferences might be drawn from this). If this information is likely to be probative, and the CMA indicates how it is likely to be used, then merging firms may be more likely to provide this data in their merger notifications, allowing it to be considered in the Phase I process.

However, applying the economics of multi-sided markets to particular merger assessments can be challenging and risks adding more confusion than insight. The MAGs should continue to provide a practical framework for merger enforcement. Moreover, in Phase I there is a relatively short time period to make an assessment and the threshold for finding an SLC is relatively low. Therefore, the CMA should make it clear that, in Phase I, the CMA cannot be expected to seek all the data and undertake all the analysis which might be needed to provide a deeper assessment of digital mergers in multi-sided markets.

Submitted by Hugh Mullan

[26] https://www.oecd.org/daf/competition/Rethinking-antitrust-tools-for-multi-sided-platforms-2018.pdf