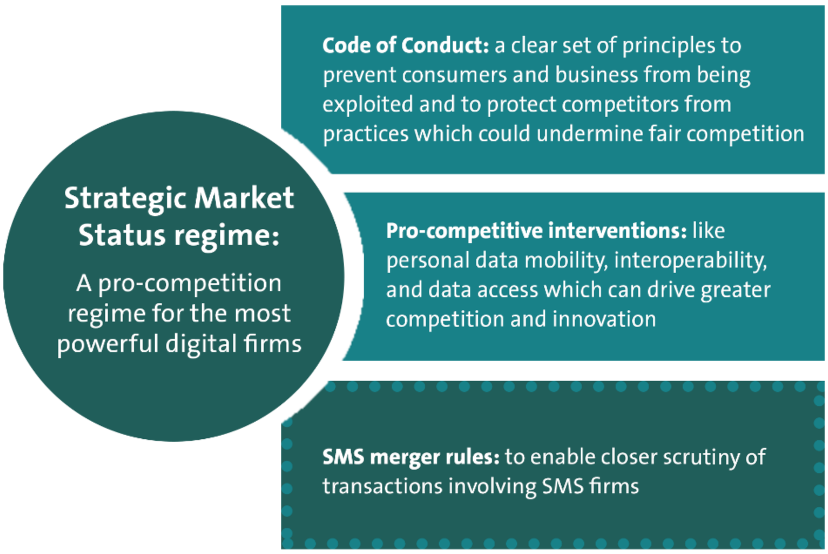
Appendix F: The SMS regime: a distinct merger control regime for firms with SMS

1. This appendix sets out our proposals for a distinct merger control regime for firms with strategic market status (SMS). These proposals are based on the recommendations from recent reports into competition in digital markets,[1] the CMA's experience of operating the mergers regime in the UK and the responses received to the call for information by the Taskforce. Detail on the SMS test and designation process is set out in Appendix B, while our proposals for the other tools of the regime – the code of conduct and pro-competitive interventions – are set out in Appendices C and D respectively. Appendix E sets out cross-cutting powers and procedures.

Figure F.1: overview of the SMS regime



Overview

2. There are widely-held concerns about historic under-enforcement against digital mergers in the UK and around the world, leading the Furman Review to

[1] Furman Review (2019), Unlocking Digital Competition; Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets; Stigler Center (2019), Committee on Digital Platforms Final Report; US Antitrust House Subcommittee Investigation of Competition in Digital Markets, 2020; Jacques Cremer, Yves-Alexandre de Montjoye and Heike Schweitzer (2019), Competition policy for the digital era, final report for the European Commission.

call for a 'reset' in digital merger assessment and 'more frequent and firmer action to challenge mergers'.[2] The Stigler report similarly concludes that authorities have permitted too many digital mergers, in particular 'rarely' challenging vertical mergers, and explains that the most powerful digital firms use their existing positions to 'derive superior insights into what firms they should block, which they should buy, and how they should grow strategically'.[3] We have carefully considered whether there are risks that the existing UK merger control regime may not be able to sufficiently address the potential harms raised by mergers involving firms with SMS.

3. In carrying out this assessment, we have considered:

(a) the specific features of the ecosystems in which the most powerful digital firms operate, and the role of M&A within their business strategies;

(b) the nature of the harm to competition and consumers that is liable to be brought about by any under-enforcement in relation to acquisitions by the most powerful digital firms; and

(c) whether there is a material risk that certain aspects of the existing primary UK merger control regime could restrict the CMA's ability to enforce effectively in digital markets.

4. For the reasons set out in detail below, we believe that there is a strong case for increased scrutiny of the acquisitions entered into by SMS firms. The introduction of additional merger control requirements for firms with SMS would, however, be a significant change to the existing regulatory regime in the UK, and the majority of mergers by firms with SMS are likely to be competitively benign (and will often have significant benefits for consumers). We have therefore carefully considered the potential drawbacks of such a regime, including the additional burden that this would impose on firms with SMS and the risk of overenforcement. We have also considered whether the establishment of a distinct merger control regime for SMS firms could have any unintended adverse impact on the existing primary UK merger regime.

5. We consider that such additional scrutiny would be most effectively and proportionately achieved by the establishment of a distinct merger control regime for firms with SMS. The SMS merger control regime would need to be designed carefully to ensure that it can achieve its objectives while minimising any unintended adverse consequences. While this will require further detailed

[2] Furman Review (2019), Unlocking Digital Competition, paragraphs 3.42-3.48 and Strategic recommendation B.
[3] Stigler Center (2019), Committee on Digital Platforms Final Report, page 50.

consideration, our current proposals for the key features of such a regime are set out below.

The need for a distinct merger control regime for firms with SMS

Recommendation 10: The government should establish the SMS regime such that SMS firms are subject to additional merger control requirements.

Characteristics of digital markets

6. The evidence from recent reports into competition in digital markets, as well as previous competition investigations by the CMA and other competition authorities, show that acquisitions by the most powerful digital firms are likely to hold particular risks for consumers, and give rise to particularly acute risks of regulatory under-enforcement.[4]

7. As a starting point, some of the most powerful digital firms have been able to develop particularly strong and entrenched market positions, now dominating the list of largest global businesses (in contrast to the position only 10 years ago).[5] As set out in Chapter 2 of the main advice, firms which once competed vigorously to gain a foothold in their markets are in many cases now amongst the most powerful global firms, and have been for a number of years. For example, Google earned over 90% of UK search advertising revenues in 2019, while more than half of all display advertising revenues went to Facebook that year.[6]

8. There is an increasing body of evidence that the lack of competition in activities dominated by the most powerful firms makes it hard for rivals to enter and compete. This is often as a result of specific market features such as network effects and economies of scale, consumer decision-making and the power of defaults, unequal access to user data and lack of transparency. These features allow the most powerful digital firms to develop and maintain

[4] For example Stigler Center (2019), Committee on Digital Platforms Final Report, sets out that 'Technology platforms […] pose unusual challenges for antitrust merger enforcement. To the extent that platforms are in winner-take-all or winner-take-most markets, mergers among significant, existing competitors, which are the mergers most subject to antitrust challenge, are likely to be rare. Instead, competition in such markets is largely for the future, often in evolving and very different markets. […] In this context, acquisition by a dominant platform of a much smaller and possibly nascent firm could be very damaging to competition if, absent the acquisition, the smaller firm would develop into a major competitive threat or would lead to significant change in the nature of the market. In a concentrated market structure, this potential competition from very small entrants may be the most important source of competition faced by the incumbent firm. The problem is that it is very difficult to know at the time of an acquisition whether the acquired firm is likely to develop into a competitor or whether, to the contrary, acquisition by the platform offers the most promising path to the commercial development and use of the acquired firm's new technology or an essential exit strategy for investors in the acquired firm' (page 88).
[5] Report regarding fact-finding survey by the Japan Fair Trade Commission (JFTC), October 2019.
[6] CMA market study into online platforms and digital advertising, final report, page 5.

particularly strong and entrenched market positions and limit important sources of potential entry and challenge by new entrants.

9. In addition, the most powerful digital firms have built large ecosystems of complementary products and services around their core service. This can raise concerns as the firm's most profitable activities are insulated from competition. Vertical integration by the most powerful digital firms can also allow them potentially to use their power in their core activity to extend into adjacent markets, building up a powerful connected ecosystem where activity in one market reinforces their position elsewhere. The Furman Review also sets out that, in many cases, digital markets are subject to tipping, with a winner taking most of the market.[7]

The role of M&A in the business strategies of the most powerful digital firms

10. M&A activity is an important part of the business model of the most powerful digital firms, with strategic acquisitions being used to reinforce an existing strong position or extend that position into adjacent markets.[8] The most powerful digital firms can also use acquisitions to build and strengthen their ecosystems of complementary products and services around their core service,[9] insulating it from competition.[10]

11. Some of the most powerful digital firms are involved in very high levels of M&A activity. The Furman Review noted that while Google, Facebook, Amazon, Microsoft and Apple have made over 400 acquisitions combined between 2008 and 2018,[11] only a handful of these transactions were subject to review by competition authorities (with none having been blocked). In many cases, the firms are acquiring targets that are at an early stage of their development,[12] making it difficult for competition authorities to assess whether (and how) the acquired firm is likely to develop into a competitor. In practice, only a very limited number of these transactions are subject to any form of merger control scrutiny.

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[7] Furman Review (2019), Unlocking Digital Competition, page 4.

[8] See for example Furman Review (2019), Unlocking Digital Competition, paragraphs 1.107-1.111, Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets, paragraphs I.46-I.69, Stigler Center (2019), Committee on Digital Platforms Final Report, pages 75-76.

[9] See for example Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets, at I.53, which sets out that most of the publicly disclosed acquisitions by Amazon, Facebook and Google between 2008 and 2018 did not have a clear horizontal element and were often complementary to the services supplied by these companies.

[10] Furman Review (2019), Unlocking Digital Competition, paragraph 3.49.

[11] Furman Review (2019), Unlocking Digital Competition, paragraph 3.44.

[12] For example, Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets noted that the median age of companies acquired by Facebook and Google between 2008 and 2018 was 2.5 and 4 years respectively (section I.3, page ii).

Potential harm to competition and consumers

12. The evidence from recent reports on competition in digital markets, as well as previous competition investigations by the CMA and other competition authorities, also shows that acquisitions by SMS firms are likely to hold particular risks for consumers, given the particularly widespread and significant effects of the market power that they already hold, and therefore give rise to particularly acute risks in the event of regulatory under-enforcement.

13. As described in more detail in Chapter 2 of the main advice, as well as the market study, the accumulation and strengthening of market power by the most powerful digital firms (including through mergers) has the potential to cause significant harm to consumers, including through lower levels of innovation and choice, lower service quality, as well as higher-priced goods and services across the economy. Harm can also occur where powerful firms can extend their strong position in one activity into other activities, potentially acting as a handbrake on innovation across the ecosystem of online services and related technology.[13]

14. Mergers involving digital firms will often raise issues around the loss of dynamic or potential competition, particularly if acquiring targets at an early development stage, where either the target or the acquirer could have developed products and services in competition with the other firm. Where a merger is between firms at different levels of the supply chain, it may also allow the acquirer to cement its position in its core market (or expand it into an adjacent market), insulating it from competition and disruptive innovation.

15. Harms to innovation from mergers can result in potentially large losses to consumers.[14] For example, the Furman Review sets out that harms to innovation from mergers may result in a 'potentially very large scale of lost benefit if the merger prevents competition from emerging in that digital market.'[15] Similarly, the Stigler Report notes that, in concentrated markets, potential competition from very small entrants may be the most important source of competition to an incumbent firm and that acquisitions by a dominant platform could be 'very damaging' to competition.[16] The strengthening of market power by the most powerful digital firms through

[13] CMA market study into online platforms and digital advertising, final report, paragraph 2.85.
[14] Loss of innovation is discussed frequently in the Furman Review (2019), Unlocking Digital Competition, for example in paragraph 1.157,and paragraphs 3.51-3.52.
[15] Furman Review (2019), Unlocking Digital Competition, paragraph 3.82.
[16] Stigler Center (2019), Committee on Digital Platforms Final Report, page 88.

mergers can also affect quality and choice in adjacent markets, leading to further losses to consumers.

Potential limitations of the existing UK merger control regime

16. The CMA has reviewed over 20 mergers in digital markets in the last two years and regularly analyses a broad range of theories of harm, including in relation to innovation and access to data. The CMA has also developed its practice and assessment of dynamic counterfactuals and valuation analyses.[17] In mergers involving multi-sided platforms,[18] the CMA now regularly takes into account the impact of the merger on all sides of the market. The CMA is also currently consulting on an updated version of its Merger Assessment Guidelines which includes, among other changes, additional guidance relevant to the assessment of mergers in digital markets.[19]

17. While, in our view, the UK merger control regime remains broadly fit for purpose, the CMA's recent experience in operating the UK merger control regime suggests that there are risks that certain limits to the existing primary merger regime, set out in further detail below, could restrict the CMA's ability to enforce effectively in digital markets.[20]

Potential limitations in the current jurisdictional tests

18. The CMA only has the power to investigate a merger (and, ultimately, where that merger raises competition concerns, to prohibit it or allow it to proceed only subject to conditions) where the merger meets one of the specified jurisdictional tests – known as the 'turnover' test and the 'share of supply' test.

19. The turnover test (which requires the business being acquired to generate annual revenues of at least £70 million in the UK) is primarily intended to capture acquisitions of targets with an established market presence. There is a risk, however, that this test fails to capture many transactions entered into by the most powerful digital firms, which often involve the acquisition of nascent, potential competitors, as well as targets whose early stage business

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[17] The counterfactual is the competitive situation without the merger.
[18] Ie firms allowing multiple groups of users to interact, such as social media platforms or price comparison websites.
[19] Draft revised guidance: Merger assessment guidelines (2020, currently under consultation).
[20] The merger control-related reforms put to government in February 2019 were not primarily aimed at supporting the CMA's ability to enforce effectively within the digital sector (other than the proposed reporting mechanisms, elements of which are included in the proposed SMS merger regime) and are therefore not considered within this Appendix. The CMA continues to conduct further work to consider whether other changes to the UK merger control system (including the possibility of making some or all mergers subject to mandatory and suspensory notification) could be appropriate.

model is to initially offer 'free' services to consumers. Recent experience with acquisitions in digital markets indicates that the target businesses often generate low or zero revenues in the UK, meaning that the turnover test is not met.[21] This might be because the acquisition takes place at an early stage of a target's lifecycle, before it is generating significant revenue, or because its monetisation strategy does not involve directly generating revenue in the UK (eg where it operates in a multi-sided market).

20. The share of supply test captures transactions where the merging businesses overlap in the supply of a particular type of goods or services and the merger creates or increases a combined 'share of supply' of at least 25% in the UK. This test has, in practice, previously captured acquisitions of nascent competitors (such as Google's acquisition of Waze and Facebook's acquisition of Instagram). There is, however, again a risk that this test fails to capture many transactions entered into by the most powerful digital firms, which often involve moving into adjacent markets, for example because it cannot capture mergers where the relationship between the merging parties is purely vertical in nature (ie they do not overlap).

Risks that arise in the substantive assessment of digital mergers

21. Even when the CMA has the power to investigate a merger, difficulties can arise in establishing that there is a sufficient likelihood of consumer harm to justify intervening in that merger, even if the potential harm is very large.

22. While the most powerful digital firms already hold significant market power, and under-enforcement carries particularly acute risks for consumers, the threshold to establish that a transaction raises competition concerns remains high. The CMA can ultimately only intervene in a merger where it establishes that the merger gives rise to a substantial lessening of competition (SLC) on a 'more likely than not' basis (ie on the balance of probabilities). Many transactions entered into by the most powerful digital firms involve moving into adjacent markets or the acquisition of nascent, potential competitors, which may be generating little or no revenue in the UK. Those transactions could raise competition concerns where, for example:

- the target could, in future, have developed into a more direct competitor to the acquirer (eg by expanding its service offering and/or scale);
- the target is, in and of itself, a significant asset that could have supported the entry or expansion of a potential competitor to the acquirer; and/or

[21] See for example, Google/Looker and Facebook/Instagram.

- the acquirer may pursue a foreclosure strategy, either to reinforce an existing strong market position or to extend its position into the market in which the target is active.

23. In each case, a forward-looking assessment is required. This can be particularly challenging where a merger involves the acquisition of a target business at an early stage of its development or where markets are rapidly evolving. In such circumstances, the competitive significance of the target can be difficult to assess, and there can be significant uncertainty about how the target, and the market more generally, is likely to develop in future.

24. A merger can give rise to an SLC on the balance of probabilities standard even if there is uncertainty as to how the market is likely to develop in future. In particular, the fact that there may be some uncertainty as to how the market is likely to develop does not, by itself, reduce the likelihood that a merger gives rise to competition concerns. When assessing whether the SLC test is met, the CMA is also not required to apply the 'balance of probabilities' test to each step in its analytical process (including the assessment of the most likely counterfactual).

25. Nevertheless, establishing that a merger gives rise to an SLC on the balance of probabilities standard can be particularly challenging in digital mergers, where there is often considerable uncertainty about how the market, or the business that is being acquired, is likely to develop in future. At present, a merger can only be blocked where consumer harm (in the form of an SLC) is the likely outcome, resulting in a risk of false negatives. As a result, there is a serious risk that mergers that have considerable potential to cause significant harm to UK consumers, but where this cannot be considered as the likely outcome at the time that the decision is taken, would be cleared. This risk was highlighted in recent expert reports, such as the Furman Review, which noted that the current framework for assessment can 'make it hard to demonstrate that a substantial lessening of competition is more likely than not, despite the potentially very large scale of lost benefit if the merger prevents competition from emerging in that digital market'.[22]

26. The risk of false negatives is further compounded where the evidence base consists predominantly of static, historic evidence such as market shares or switching data. This type of evidence will typically be less informative when assessing theories of harm based on future developments. The CMA has increasingly interrogated merging parties' internal documents, as well as evidence on deal valuation, when considering losses of actual and potential

[22] Furman Review (2019), Unlocking Digital Competition, paragraph 3.82.

competition in digital markets. However, this raises risks that merging parties may take the possibility of merger review into account in their internal documents and communications, limiting the weight that can be attached to them.[23]

Difficulties caused by the partial integration of digital businesses

27. In addition, we also consider that the voluntary nature of UK merger control raises particular risks with transactions by SMS firms. As UK merger control is voluntary, merging parties are able to complete (or 'close') transactions prior to clearance. In practice, the CMA often begins its investigation after an acquisition has already completed and integration has begun.

28. Where the CMA investigates a completed merger, it will typically impose a 'hold separate' order, known as an initial enforcement order, requiring the merging parties to operate their businesses independently of each other and not to integrate further.[24] In practice, given the nature of powerful digital firms, there can be particular difficulties in unwinding integration that has already taken place (which can give rise to significant cost and uncertainty for both the CMA and the businesses involved in the transaction).

29. Difficulties might arise in relation to unwinding transactions in digital industries, where the businesses involved often lack tangible assets, such as production sites or plant, that can be readily carved out and divested. As the commercial value of these firms often lies in their IP rights, data, algorithms, key personnel, user base and growth expectations, the competitive strength of the target business can be irreversibly damaged as soon as an acquirer takes control of these assets. At that point, the acquirer may also immediately realise significant benefits from the transaction that cannot later be reclaimed (eg by gaining access to competitively sensitive information on the target's data and algorithms, which once seen, cannot be forgotten). Where competition concerns are ultimately found in such circumstances, unwinding the transaction might not be sufficient to restore the competitive structure to the pre-merger situation.

Drawbacks and unintended consequences

30. The introduction of additional merger control requirements for SMS firms would be a significant change to the existing system of merger control in the UK. As with the introduction of any additional regulatory requirements, we

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[23] For example, an internal Google training document obtained by a non-profit newsroom sets out guidelines for written communications that might be disclosed to antitrust regulators.
[24] Interim measures in merger investigations (CMA 108).

have carefully considered the potential disadvantages and unintended consequences of additional merger control scrutiny for SMS firms, and how any additional burdens could be minimised without undermining the objectives of the regime.

Additional regulatory burdens

31. While the SMS merger control regime will impose additional reporting requirements on SMS firms, we do not believe that these are out of keeping with the overall costs and benefits of the broader SMS regime.

32. To the extent that additional merger control notifications are required to be made to the CMA, this obligation would only be triggered where the value of the transaction is above a specified threshold of materiality. In such circumstances, any costs incurred in notification are likely to form only a limited proportion of the overall cost of a transaction for an SMS firm, in light of the consideration paid and the other transaction-related costs (not related to merger control requirements), such as the fees of financial and legal advisers.[25] Moreover, as explained further below, mechanisms would be put in place to reduce the costs and burdens related to notification wherever possible, including a simplified review process for transactions that self-evidently do not raise competition concerns.

33. The introduction of a suspensory obligation for qualifying transactions could also give rise to costs resulting from delays in the realisation of deal-related synergies. These costs already exist today to some extent, as an initial enforcement order will typically prevent further integration once a CMA investigation has been initiated. Moreover, the clear-cut nature of the jurisdictional tests will ensure that SMS firms have a full picture of their 'hold separate' requirements in advance of signing, so will not face unexpected costs relating to the subsequent imposition of an initial enforcement order.

34. Concerns have also been raised that introducing additional merger control obligations on SMS firms could result in decreasing investment into innovative, nascent businesses, which may rely on being sold to powerful digital firms as an exit strategy.[26] We do not believe that these concerns should be overstated. As already noted, additional merger control notifications would only be triggered once certain clear-cut materiality thresholds have

[25] For example, Tesco plc and Booker Group plc disclosed that they estimated incurring around £17.3 million in legal fees in connection with their merger (and we understand that only a proportion of those costs would have been accounted for by legal fees relating to merger control requirements). The firms also estimated incurring between £33.3 million and £35.5 million in financial and corporate broking fees. In that case, the merger filing fee amounted to £160,000.
[26] Stigler Center (2019), Committee on Digital Platforms Final Report page 88.

been met and mechanisms would be put in place to reduce the costs and burdens related to notification wherever possible, including a simplified review process for transactions that self-evidently do not raise competition concerns. We therefore consider that the risk of a 'chilling-effect' on investment is limited and in any event does not outweigh the potential risk of harm.

The risk of over-enforcement

35. Any merger control regime has to carefully balance the risks of over-enforcement and under-enforcement. As set out in more detail elsewhere in our advice, there are widespread concerns about under-enforcement in relation to acquisitions by SMS firms and the consequences of under-enforcement within this sector could be very significant.

36. Under the SMS merger control regime, the bar to prohibit any merger (or clear that merger with conditions) would continue to be significant. Any acquisition could only be blocked (or cleared subject to remedies) based on clearly articulated merger-specific competition concerns, following a full phase 2 process (overseen by independent decision makers) that would include significant evidence-gathering and analysis. The merging parties would have several opportunities, during this process, to exercise their rights of due process and make their case directly to the decision makers. We therefore believe that the risk of pro-competitive or competitively benign transactions being prohibited is limited.

Unintended consequences for the existing UK merger control regime

37. The introduction of distinct merger control obligations for firms with SMS would add further complexity to the UK merger control regime. The UK's merger control regime already has two separate jurisdictional tests.[27] The UK merger control regime is also virtually unique in being a voluntary (and non-suspensory) regime.

38. The potential impact of this additional complexity should not, however, be overstated. The SMS merger requirements would apply only to a small set of firms that are large and sophisticated companies and already have significant experience in competition law compliance, including merger control.

39. The operation of a distinct merger control regime for firms with SMS would require additional public resources to be expended on merger control. Overall,

[27] There are also separate thresholds for companies with certain specified activities (albeit that these are motivated by public interest rather than competition considerations). These lower thresholds would fall away if the National Security and Investment Bill receives royal assent (see Schedule 2 of the National Security and Investment Bill).

as with the broader SMS regime, we believe that these costs are justified by the potential benefits of the regime. The SMS merger regime should also be designed in a way that ensures that public resources are used most effectively. In particular, the CMA should oversee the SMS merger regime because splitting the UK's merger control responsibilities between two different bodies would also likely result in the duplication and dilution of expertise and resources across two regulators. The thresholds that trigger mandatory notification should be carefully designed to ensure that only transactions that appear to be most likely to have a substantial impact on competition in the UK are subject to mandatory merger notification. The introduction of a mandatory and suspensory merger regime for these transactions would also ensure that resources can be targeted at investigating the substantive concerns a transaction might raise, rather than on interactions relating to initial enforcement orders.

Conclusion

40. In light of the widespread and significant risks that arise from acquisitions by firms with SMS, we consider that there should be additional merger control requirements for these acquisitions, in the form of a distinct merger control regime.[28] We believe that adopting such a regime would proactively address the risks to consumer harm identified above.

The key elements of the SMS merger control regime

Recommendation 11: The government should establish the SMS merger control regime such that SMS firms are required to report all transactions to the CMA. In addition, transactions that meet clear-cut thresholds should be subject to mandatory notification, with completion prohibited prior to clearance. Competition concerns should be assessed using the existing substantive test but a lower and more cautious standard of proof.

41. The SMS merger control regime would need to be designed carefully, to ensure that it can achieve its objectives while minimising any potential disadvantages of additional merger scrutiny and unintended adverse consequences. While this will require further detailed consideration, our

[28] Heightened scrutiny of mergers by SMS firms through a separate merger control regime was supported by several respondents to the call for information. The main reasons given for such higher scrutiny included (amongst others) that the majority of acquisitions by the most powerful digital firms are not currently notified, that mergers of start-up firms in digital markets can negatively impact on innovation and that mergers may enable incumbents to expand their market power into adjacent markets.

current proposals for the key features of such a regime are set out below. In particular, we have considered:

(a) who should operate the regime;

(b) what transactions should be captured by the regime, and what requirements should apply to these transactions;

(c) how substantive competition concerns should be assessed under the regime; and

(d) how non-competition concerns should be assessed under the regime.

42. This section addresses these considerations in turn, setting out our recommendations on each point.

The SMS merger control regime should be operated by the CMA.

43. The CMA is the UK's specialist competition authority and operates the UK's existing primary merger control regime. Importantly, the CMA operates this merger control regime across all industries, including those regulated by other sectoral competition regulators.

44. The CMA would therefore be well-placed to operate the SMS merger control regime alongside the wider merger control regime. The CMA already reviews acquisitions by the most powerful digital firms under the existing primary merger control regime,[29] and in recent years has been increasingly active in scrutinising digital mergers. For example, in 2019 it initiated investigations into Amazon's investment in Deliveroo and Google's acquisition of Looker. Following the recommendations of recent reports on competition in digital markets, the CMA has significantly evolved its evidence gathering tools and analytical processes (and has now consulted on its substantive guidance) to better investigate the theories of harm that are liable to arise in digital mergers.

45. If an alternative body was established to administer the SMS merger control regime and undertake competition assessments for these mergers, this would lead to several avoidable risks, including the duplication and dilution of expertise and resources across two separate regulators. It would also increase the risk of inconsistent interpretation of legal, economic and practical concepts common to both regimes.

[29] As does the European Commission, although future cases that previously would have been examined by the European Commission will fall under the CMA's jurisdiction after 31 December 2020.

The SMS merger control regime should apply to all transactions entered into by SMS firms. SMS firms should be required to report all transactions to the CMA, with transactions that meet clear-cut thresholds subject to mandatory notification.

46. The SMS merger regime should be based on two broad requirements. First, SMS firms would be required to make the CMA aware of all transactions that they enter into within a short period after signing. Second, certain transactions entered into by SMS firms that meet bright-line threshold tests should be subject to mandatory merger control notification.

47. Both of these requirements are described in more detail below.

The SMS merger control regime should include a mandatory reporting requirement for all transactions entered into by SMS firms.

48. We propose that SMS firms would be required to make the CMA aware of all transactions they enter into within a short period after signing. This requirement would apply to the acquisitions of all interests in enterprises (including shareholdings at any level) but would not apply to acquisitions of 'bare assets'.[30]

49. This would allow the CMA to verify whether the jurisdictional tests that govern whether transactions subject to mandatory notification are being applied appropriately, as well as supporting the CMA's monitoring of transactions that fall outside the thresholds for mandatory notification (which, as explained further below, could fall to be investigated in circumstances where a transaction that does not trigger the thresholds for mandatory merger control notification could nevertheless raise competition concerns in the UK). This reporting would also, over time, inform the CMA's understanding of the M&A activities of the SMS firms, which would facilitate any *ex post* assessment of the operation of the SMS merger regime once it is up and running.[31]

50. This reporting requirement would also allow the other regulators that consider non-competition concerns (whose activities are described further from paragraph 134 below) to be made aware of investment and acquisition

[30] Paragraphs 4.10-4.19 of the Draft CMA Merger guidance on jurisdiction and procedure (2020, draft under consultation) discuss the term 'enterprise' and what the CMA would typically consider that this constitutes.

[31] Mandatory reporting of all acquisitions by firms with SMS was recommended in the Furman Review (2019), Unlocking Digital Competition, page 12. It was also supported by several respondents to the call for information). Finally, the ACCC has reported that it may consider it appropriate to request that certain businesses (such as the most powerful digital platforms) notify the ACCC in advance of all proposed acquisition of entities that carry on business in Australia (see page 10 of the ACCC's Digital Platforms Inquiry Final Report (2019)).

activities by firms with SMS, and to assess whether they should use their existing powers to intervene.

51. The reporting requirement would take the format of a simple form (approximately one page in length), requiring certain key information, such as: the target business's name; the nature of the target business's activities (and their relation to the UK); the consideration involved; whether the transaction is subject to mandatory notification under the SMS merger control regime; and the proposed date of completion. This information should be readily accessible to the SMS firm, and therefore would be required to be provided to the CMA within a short period (eg two weeks) of signing the relevant acquisition document.

52. This would be a mandatory obligation for all SMS firms. Penalties (in the form of fines) would be imposed where an SMS firm failed to make the CMA aware of a relevant transaction within the applicable period.

Acquisitions of clear-cut levels of control by SMS firms that meet clear threshold tests should be subject to mandatory notification under the SMS merger control regime.

53. We propose that certain transactions entered into by SMS firms that meet bright-line threshold tests should be subject to a mandatory and suspensory merger control requirement. Our preferred option would be that these threshold tests are designed to establish a transaction's materiality and nexus to the UK, although further consideration is necessary to assess how these design needs might be achieved in practice.

54. The SMS merger control regime would result in qualifying transactions being subject to mandatory notification, with penalties (in the form of fines) imposed where SMS firms fail to comply with this requirement. It is therefore particularly important that the thresholds that determine whether a transaction is subject to mandatory notification are clear-cut in nature and straightforward to apply in practice.

55. While, as noted above, further work is required on the design of the regime, our current proposals for the key elements of the regime are set out below.

The ability to exercise control over another business would trigger a filing requirement, with further consideration to be given to whether shareholdings at lower levels should also require mandatory notification.

56. In keeping with the principle set out above, we propose mandatory filing requirements should only apply to clear-cut acquisitions of control (including both 'de jure' control and 'de facto' control).[32]

57. 'Control' is an objectively understood concept that appropriately captures the different ways in which an acquirer can obtain influence over a target business. It would capture a range of transactions, including those short of 100% control, where SMS firms are obtaining sufficient influence such that competition concerns may be more likely to arise (compared to smaller investments where the SMS firm may have less ability or incentive to pursue such strategies). This would include situations where a firm moves from one level of control to another (for example from a minority shareholding to de facto control), as is current practice under the existing UK, and other, merger regimes.[33]

58. At this stage, we propose that the acquisition of 'material influence', which is a less clear-cut standard of control, would not trigger a filing under the SMS merger regime. While the acquisition of this level of control can trigger jurisdiction under the existing primary merger regime, this is not a bright-line test, and requires a careful case-by-case analysis of the overall relationship between the acquirer and the target. While this test is a useful jurisdictional gateway within a voluntary merger control regime, it is not suited to a regime in which penalties (in the form of fines) can be imposed for the failure to notify.

59. In designing the SMS merger control regime, detailed consideration should also be given to whether shareholdings at lower levels should also require mandatory notification. Through a minority shareholding (above a certain level), an SMS firm may be able to influence the target business's strategy, resulting in a lessening of competition that could give rise to consumer harm. Assessing the impact of such a minority shareholding could enable early intervention before commercial strategies irreversibly change the way a market evolves over time. On the other hand, the mandatory notification of smaller shareholdings would bring about an additional burden on both the CMA and SMS firms in circumstances in which the SMS firms will not gain

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[32] Under Section 26 of the Enterprise Act 2002, 'control' includes three levels of interest: material influence, de facto control and the acquisition of a controlling interest.

[33] We would also propose to treat the acquisition of control through a series of transactions or events within a defined period as constituting one merger for the purposes of whether a transaction is captured by the SMS merger control regime. This is similar to provisions in the existing primary merger regime, as set out in Sections 27(5) and 29 of the Enterprise Act 2002.

control over the commercial strategies of these firms (and where competition concerns are less likely to arise compared to acquisitions of majority control). As a starting point for further analysis, we propose that consideration should be given to whether the acquisition of a share of a company's capital or voting rights of 25% (or more) should also trigger a mandatory notification requirement under the SMS merger regime (provided the transaction also meets the clear-cut thresholds for notification as set out further below).

The requirement to notify should only apply to transactions that meet bright-line threshold tests.

60. We propose the use of bright-line threshold tests in order to ensure that the regime is properly targeted. These thresholds would be intended to ensure that transactions that appear to be most likely to have a substantial impact on competition in the UK are subject to mandatory merger notification. This would also ensure that transactions that appear to have no material impact in the UK are not subject to the requirements of mandatory (and suspensory) notification (although, as described further below, consideration should be given to what kind of 'safety net' should exist for transactions that are not subject to mandatory notification but could nevertheless raise competition concerns). This would reduce the burden of the potential regime on both the SMS firms and their targets, as well as the CMA.

61. In keeping with international best practice for mandatory regimes, the thresholds should be clear, objective, and easily measured, providing merging parties with certainty about when they need to file.[34] The thresholds also need to be designed carefully to ensure that they enable the investigation of transactions that could have appreciable competitive effects within the UK, while minimising unnecessary burdens on business and the CMA. In keeping with the broader purposes of the SMS regime, such thresholds should not rely only on the current market position of the target entity (which will often be a young and fast-growing business).

62. Within this context, we have considered several possible thresholds to filter out transactions that are not material and transactions with no connection to the UK, including:

- turnover-based thresholds;

[34] See the International Competition Network Recommended practices for merger notification and review procedures (2018); and Setting notification thresholds for merger review (2008). See also, Organisation for Economic Cooperation and Development Executive summary of the roundtable on jurisdictional nexus in merger control regimes (2016).

- thresholds based on interactions between the activities of the merging parties (ie whether there is a horizontal overlap and/or vertical or conglomerate links between the activities of the target and those of the acquirer);
- transaction value-based thresholds; and
- a nexus test based on the target business's activities in relation to the UK.

63. ***Turnover-based thresholds:*** Turnover-based thresholds are used in many jurisdictions and can provide an easily measured filter in relation to both materiality and local nexus. As noted above, however, the businesses acquired by the most powerful digital firms are often young and fast-growing and may only generate low or zero revenues in the UK, despite having a significant link to competition and markets that impact UK consumers. For this reason, we consider that a turnover threshold would not be a reliable way to filter out transactions of limited materiality from merger control review.

64. ***Thresholds based on interactions between the activities of the merging parties:*** Thresholds based on the existence of horizontal overlaps and/or vertical or conglomerate links between the merging parties are used in a small number of jurisdictions. In theory, such a threshold (being based on competitive interactions) would be well suited to ensuring that only the most material transactions are subject to notification. In practice, however, the delineation of relevant markets, for the purpose of competition assessment, is not straightforward. The interactions between different products and services (and the way that such products and services are used by customers) can also be disputed. Moreover, it would be particularly difficult to design such a threshold to capture potential competition concerns.

65. A threshold based on limited horizontal or vertical overlaps would require merging parties to conduct a self-assessment, based on an initial understanding of the activities of the target business and how they might relate to the existing activities of the acquirer. This assessment may not always be straightforward and the nature of this kind of assessment (which could be complex, lengthy and resource-intensive, and require a material amount of evidence-gathering from the merging parties and third parties) makes it best suited to the substantive assessment of the merger, rather than forming part of a clear-cut jurisdictional test.

66. Accordingly, we consider that thresholds based on interactions between the activities of the merging parties would not be sufficiently clear-cut for a mandatory merger control regime.

67. ***Transaction value-based thresholds:*** Transaction value-based thresholds are also used within several jurisdictions (including the USA, Canada, Germany, Austria and Japan).[35] While such thresholds have to be specified carefully (to minimise circumvention risks), they are generally clear, objective and easily measurable.

68. In principle, the value of the transaction should provide a reasonable proxy for the materiality of that transaction. The purchase price paid by the acquirer is likely to reflect the significance of a target business given that it should broadly reflect the outside options of the seller (eg whether to sell the business to another bidder or to continue to operate the business with a view to profiting in the longer-term, for example by pursuing an initial public offering). Our preferred option would therefore be to assess the materiality of a transaction by reference to its transaction value (similar to the tests used in other merger control regimes). The level of such a threshold should be carefully considered in order to ensure that the CMA is able to intervene in transactions that could have a material impact within the UK, without requiring the notification of large numbers of transactions that self-evidently are unlikely to raise competition concerns.

69. Some commentators have raised concerns that transaction value thresholds in merger control risk having 'chilling effects' on the acquisitions of young or fast-growing targets and could hamper innovation by constraining the ability of start-up businesses to monetise their innovations.[36] We have not seen sufficient evidence to be able to conclude that these concerns are likely to be borne out. In this context, we note that Germany's transaction value thresholds are due to be retained as part of its draft competition law reform act, and that the USA has had such thresholds for several decades.

70. ***UK nexus requirements***: Thresholds incorporating some form of local nexus test are used in several jurisdictions (including Germany and Austria). As a transaction value-based threshold would not, on its own, necessarily indicate whether a transaction is capable of having an appreciable effect on competition in the UK, a local nexus test would be intended as an additional check that the target business had a meaningful connection to competition in the UK.

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[35] A transaction value-based threshold was suggested by a few respondents to the call for information as an appropriate jurisdictional threshold. A few others suggested that lowering the turnover test threshold could be appropriate, and another that a test similar to the share of supply test could be used, but without the requirement for an increment and with the requirement that the target is active in a related market.

[36] Responses to the BKA and BWB consultation (2018) on introducing a transaction value threshold: Merger Streamlining Group and International Bar Association.

71. The nexus of a transaction can be assessed by reference to certain clearly defined criteria relating to the activities of the target business in a given jurisdiction, such as revenues, assets, or end-users, intended to establish that the activities being acquired have a material connection to that jurisdiction. For the SMS merger regime, the nexus test would need to be designed carefully to ensure that it is sufficiently clear-cut while capturing the commercial realities of acquisitions that often involve young and developing digital businesses (that may generate limited revenues and/or have a limited physical presence in the UK) and the nature of the competitive harms that the regime is intended to address (including a loss of potential competition).

72. In principle, the UK nexus of a transaction could be assessed by reference to certain clearly defined criteria relating to the activities of the target business in the UK. Further analysis is required, however, to assess whether it is possible to design a UK-focussed test that is clearly defined but also capable of capturing transactions that raise concerns around potential competition (the loss of which is one of the key concerns liable to be raised by acquisitions by the most powerful digital firms), given that this is one of the critical components of the SMS merger regime.

The SMS merger regime should apply to all acquisitions entered into by the firm and would not be limited to acquisitions related to its 'designated activities'.

73. As set out in more detail in Appendix C, the proposed code of conduct would apply to a subset of the SMS firm's activities, centred around those activities that were the focus of the SMS designation process. We do not, however, propose to limit the SMS merger control regime to acquisitions that relate to those designated activities.

74. A key concern motivating the SMS regime is the ability of an SMS firm to use its position in a designated activity to extend its market power into other activities. As set out in Chapter 4 of the main advice, we consider that such conduct would be covered by the code (given that the SMS firm's conduct in the designated activity is the source of concern in that circumstance). We also consider it important that the SMS regime should be able to address the concerns that might arise when a firm seeks to further entrench the position of its designated activity through actions taken in its wider ecosystem. For that reason, the code can apply outside the designated activity where such conduct may affect competition in the designated activity.

75. The same principles apply to the acquisitions entered into by an SMS firm. It can, however, often be difficult to determine, in a clear-cut manner, how a target business's activities might relate to the core activities of an SMS firm. Given the importance of bright-line threshold tests for SMS firms to be able to

assess when mandatory notification is required, we think that this kind of assessment is not suited to a jurisdictional test. We therefore propose that the SMS merger regime should apply to all transactions entered into by the SMS firm and that the connection between the target business's activities and those of the SMS firm should be considered in the substantive assessment of the merger. This means that the SMS merger control regime should apply to the entire firm designated as having SMS status, irrespective of the legal entity within the firm with SMS making an acquisition or how the target business relates to the SMS firm's designated activities.

76. Seeking to limit the SMS merger regime to the designated activities of the SMS firms would materially increase the complexity of the regime while also decreasing legal certainty. It would introduce significant uncertainty for the SMS firms about whether they need to notify a merger under the SMS merger regime (or face significant fines), given that it may not always be clear to what extent the activities of the target businesses overlap with or otherwise relate to the designated activities of the SMS firm. This could result in a lengthier and more resource-intensive process than under a more clear-cut regime (and risk undermining many of the process benefits of a clearly-defined system of mandatory notifications with a prohibition on closing pre-clearance that are described above).

77. Limiting the SMS merger regime in this way could also risk undermining the effectiveness of the regime. In particular, the interaction between the activities of the acquiring SMS firm and the target business may often not be clear (particularly within markets that are evolving or when their activities are related either vertically or in adjacent markets). While it will typically be possible to dismiss any concerns arising from the acquisitions of businesses that have no connection to the SMS firm's existing business, it is most appropriate for these concerns to be dismissed in a substantive competition investigation (involving focussed evidence-gathering and analysis) rather than under bright-line jurisdictional rules.

A simplified notification process should be used to eliminate competition concerns following a 'light-touch' investigation where there is clearly no competitive interaction between the activities of the SMS firm and target.

78. Where it can readily be established that there is no competitive interaction between the SMS firm and the activities of the target firm, it may be appropriate to operate a simplified notification process to eliminate competition concerns. This could be determined based on a lack of horizontal, vertical and/or conglomerate links between the activities of the merging parties.

79. Simplified review processes form part of several merger control regimes (eg over 70% of merger cases notified to the European Commission in 2019 were examined under its simplified procedure).[37] In practice, the use of a simplified procedure materially reduces the burdens of notification on the regulator and the merging parties. Clearly defined criteria, set out in guidance, would explain the bases upon which a merger would qualify for use of the simplified procedure. In practice, the criteria would be used as a guide to parties (and CMA staff), but the CMA would ultimately maintain a broad discretion to withdraw the use of the simplified procedure where appropriate at any time prior to its final decision. Simplified procedures are typically characterised by a shorter review period and the issuance of a short pro forma decision (without any consideration of market definition or competitive analysis).

80. Further consideration should be given to the criteria which would be applied in deciding whether a merger is suited to a simplified procedure and how this process would work in practice.

The CMA should retain the ability to review acquisitions by firms with SMS that did not trigger mandatory notification under the SMS merger regime.

81. While the mandatory notification regime would be designed to capture the transactions that appear most likely to raise concerns, we propose that there should be some form of 'safety net' that would enable the CMA to review acquisitions by firms with SMS that did not trigger mandatory notification (such as acquisitions of material influence) but could nevertheless raise competition concerns.

82. This would avoid any enforcement gap in the rare circumstances in which an acquisition by a firm with SMS fell outside the jurisdictional thresholds for the SMS merger regime but could nevertheless raise competition concerns. It would also reflect a proportionate approach, under which the transactions most likely to raise competition concerns would be subject to a mandatory and suspensory notification requirement.

83. More detailed consideration will have to be given to the design of this mechanism (including, for example, whether the operation of the existing merger control regime or some other form of 'call-in' would be an appropriate way of achieving this aim). In any case, other than the requirement to make the CMA aware of these transactions, they would not be subject to the prohibition on closing prior to clearance.

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[37] Merger Statistics published by the Directorate-General for Competition.

Transactions qualifying for mandatory notification should be subject to a prohibition on closing.

84. At present, the UK merger regime does not prevent merging parties from ‘closing’ (ie implementing) a transaction before receiving merger control clearance. As explained above, we consider that the closing of transactions involving SMS firms before or during a CMA investigation gives rise to significant risks, particularly in relation to the availability of effective remedies in the event that a transaction is ultimately found to raise competition concerns.

85. We therefore propose that the transactions that qualify for mandatory merger control notification under the SMS merger regime would be subject to a prohibition on closing prior to obtaining merger control clearance (whether unconditionally or subject to conditions).

86. The prohibition on closing would be intended to protect against any action that might prejudice the outcome of the CMA’s investigation or impede the putting in place of remedies (if the merger is ultimately found to raise competition concerns).[38]

87. A strict prohibition on closing is the natural counterpart to a mandatory merger control regime with bright-line thresholds (with a similar bar on closing being applied by the vast majority of merger control regimes around the world). A prohibition on closing is also justified by the potential difficulties in unwinding integration in relation to acquisitions by SMS firms, where the competitive strength of the target business can be irreversibly damaged as soon as an acquirer takes control of these assets, which mean that the risks of pre-emptive action are particularly acute.

88. While the existing primary UK merger control regime is voluntary in nature, the benefits provided by a voluntary regime are of limited relevance to the proposed SMS merger regime. First, while the voluntary merger control regime enables the CMA to focus its resources on the mergers that are most likely to raise competition concerns across the thousands of mergers entered into each year across a range of sectors in the economy, such prioritisation is less relevant for the SMS merger regime given the far smaller total number of mergers entered into by the SMS firms. Second, while the voluntary merger regime facilitates the use of flexible triggers for jurisdiction, such as the share

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[38] We consider there may be certain exemptions to the general prohibition on closing, similar to those currently provided for under the EU Merger Regulation (Council Regulation (EC) No 139/2004). This includes a reduction in the ‘stand-still’ obligations that apply in the context of a public takeover bid, and in some exceptional circumstances, such as where a delay to the transaction poses a real threat to the business eg in the case of an emergency rescue package.

of supply test and the material influence level of control, the SMS merger regime would be based on bright-line triggers for notification.

Competition concerns should be assessed more cautiously to reflect the more acute risks of under-enforcement of acquisitions by firms with SMS. We recommend using the existing substantive test, but with a lower and more cautious standard of proof, although further consideration should be given to alternative options.

89. In order to block a merger, or to allow it to proceed only subject to conditions, the CMA is required to consider whether a merger might be potentially harmful to consumers. In order to conduct this assessment, a merger must be assessed against a specified substantive test (ie that the merger is expected to harm competition) to a specified standard of proof (ie the strength of evidence needed to show this).

90. In assessing competition concerns, the SMS merger regime should reflect the particular risks presented by acquisitions by firms with SMS and the potential limitations of the existing primary merger regime. Mandatory notification (as explained above) will address some but not all of the risks of under-enforcement that have been identified, and we propose that it is necessary to go further.

91. While we consider that the existing SLC substantive test (used in the existing primary merger regime) remains fit-for-purpose, we consider, for the reasons explained above, that a higher degree of caution is warranted in the competition assessment of mergers by SMS firms given the significant risks raised by the under-enforcement of the acquisitions by SMS firms. We therefore propose that competition concerns should be assessed using a lower and more cautious test, consistent with the principles set out in several of the expert reports.[39] This could be achieved in a number of ways, including by:

- changing the substantive test used to assess competition concerns;
- changing the allocation of the burden of proof; and/or
- changing the standard of proof required to establish intervention is warranted.

[39] Including Furman Review (2019), Unlocking Digital Competition and Stigler Center (2019), Committee on Digital Platforms Final Report. Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets also recommended that competition authorities accept increased uncertainty in their assessments of digital mergers in order to avoid under-enforcement.

92. An overview of these options for change alongside our recommendation are discussed in more detail below.

Our preferred option is that competition concerns should be assessed using the existing SLC statutory test, although further consideration should be given to the suitability of the 'balance of harms' test.

93. We propose that competition concerns would be assessed using the existing substantive test – the Substantial Lessening of Competition (SLC) test – under the SMS merger regime. The economic principles that underpin merger assessment and the competition concerns (ie unilateral, coordinated and non-horizonal effects) that mergers can raise apply equally to acquisitions by SMS firms and acquisitions under the existing primary merger regime. Within this context, the SLC test provides a well-understood yet sufficiently flexible framework to assess the competition concerns that might be raised by acquisitions by SMS firms.

SLC substantive test

94. Under the existing primary merger regime, in order to prohibit a merger, the CMA must ultimately conclude (at the end of a phase 2 investigation) that there will be, on the balance of probabilities, an SLC.

95. The Furman Review suggested that the CMA might find it difficult (given the nature of digital markets) to demonstrate at phase 2 that an SLC is more likely than not to occur in digital mergers, which could leave the CMA 'unable to challenge mergers of this kind effectively.'[40] The Furman Review therefore proposed to introduce a 'balance of harms' test that would replace the current SLC test.

96. We consider the concern raised by the Furman Review relates more to the standard of proof required to meet the SLC test in the existing primary merger regime than the analytical framework used. As explained further below,[41] the risks that arise in relation to the application of the substantive test concern the level of certainty with which competition concerns are required to be established.

97. We believe that the existing substantive test remains, in principle, largely fit-for-purpose; it enables the CMA to effectively assess competitive concerns in all transactions and ensure effective enforcement including for mergers in the digital sector. This is primarily because the existing statutory test is well-

[40] Furman Review (2019), Unlocking Digital Competition, paragraph 3.87.
[41] The standard of proof is discussed in more detail from paragraph 112.

understood, broad and enables the CMA to intervene in a wide variety of circumstances.

98. This is consistent with how the UK Courts have interpreted the statutory test. For example, in Global Radio v CC, the CAT determined that the meaning of 'substantial' (in terms of a substantial lessening of competition) is broad ranging, and can fall within a spectrum from 'not trifling' to 'nearly complete', and may best be summarised as 'worthy of consideration for the purpose of the Act'.[42] It does not need to be 'large,' 'considerable' or 'weighty'.[43]

99. In practice, there are a range of circumstances in which a lessening of competition can be found to be substantial.[44] CMA decision makers (whether CMA staff in phase 1 investigations or independent inquiry groups in phase 2 investigations) take decisions in the round, drawing on a wide range of evidence. The existing substantive test therefore already provides considerable flexibility to assess the competition concerns that might arise in acquisitions by SMS firms, including dynamic or potential competition concerns and non-horizontal concerns.[45]

The 'balance of harms' test

100. As mentioned above, the Furman Review proposed using an alternative test based on a 'balance of harms', seeing this as providing a more effective means of analysing competition concerns. This is because it would allow for the scale of potential harm to be factored into the review of the merger alongside the likelihood of it occurring.

101. We agree that the 'balance of harms' test proposed in the Furman Review would, in theory, be an attractive way of weighing whether a merger is expected to do more harm than good for consumers. We do not currently believe, however, that it is possible, in practice, to apply the test in a transparent and robust way. In particular, there would be significant challenges in quantifying all of the potential harms and benefits that a

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[42] See Global Radio Holdings Limited v Competition Commission [2013] CAT 26, paragraphs 18-25.
[43] See also Tobii AV v CMA [2020] CAT 1, paragraph 392.
[44] In particular, we consider that the CMA's previous cases show that the harm flowing from an SLC does not need to be substantial (eg Manchester Hospitals); an SLC can involve an enhancement to a dominant company's position or to market power (eg JLA/Washstation); an SLC can arise in a narrow market segment (eg Rentokil/Cannon); and an SLC can arise as a result of the elimination of a potential competitor (eg Akzo Nobel/Metlac). SLCs can also arise as a result of coordinated, vertical or conglomerate effects and the CAT has stated that there is no '*elevated evidential burden*' in cases involving non-horizontal effects (Intercontinental Exchange, Inc. v CMA and Nasdaq Stockholm AB [2017] CAT 6, paragraph 114). The CMA has already started to adapt its theories of harm in recent cases to take account of dynamic counterfactuals and the impact on potential competition and innovation (see paragraphs 2.7-2.10 and 2.17 of the Draft revised guidance: Merger assessment guidelines (2020, currently under consultation).
[45] This is evidenced by recent cases such as PayPal/iZettle, Experian/Clearscore and Illumina/Pacific Biosciences.

transaction could give rise to, and providing consistent estimates of the likelihood of those harms and benefits arising (within markets often characterised by a significant degree of uncertainty), in an appropriately clear and objective manner. The need to then perform a quantifiable balancing assessment across a combination of the likelihood and size of the potential harms against potential benefits exacerbates these practical challenges.

102. In practice, the 'balance of harms' test would therefore likely lead to the need for the CMA to use a more rigid quantitative framework in assessing mergers under the SMS regime, in contrast to the 'in the round' assessment of multiple sources of quantitative and qualitative evidence carried out under the SLC test in the existing primary mergers regime. This is likely to result in serious challenges in the context of SMS mergers where there may frequently be significant uncertainty about how the market, or the business that is being acquired, is likely to develop in the future. We therefore consider that the 'balance of harms' test would exacerbate rather than address the uncertainty concerns in these mergers.

103. On this basis, we also currently believe that it would be difficult, in practice, for merging parties to meet the burden of establishing that the potential benefits of a transaction outweigh the potential harms in the vast majority of cases (including transactions that do not have a material risk of harming consumers). We therefore believe that the 'balance of harms' test would effectively introduce a standard by which only mergers that could explicitly be shown to be pro-competitive would be permitted. We note, in this regard, that the Furman Review concluded that placing the burden of proof on merging businesses to show that a merger will not be anti-competitive would not be a 'proportionate response to the challenges posed by the digital economy' on the basis that 'the majority of acquisitions by large digital companies are likely to be either benign or beneficial for consumers, though a minority may not be'.[46]

104. For the same reasons, we consider that the introduction of the 'balance of harms' test would likely go further than is necessary to address the particular concerns that arise from SMS mergers (as set out above), and ignores that many transactions entered into by SMS firms are likely to be competitively benign.

105. We therefore currently consider that the existing substantive test (in conjunction with, as explained further below, a lower and more cautious standard of proof) remains the most appropriate way of assessing the

[46] Furman Review (2019), Unlocking Digital Competition, paragraphs 3.101 – 3.103.

competition concerns that may arise from acquisitions by firms with SMS in a proportionate manner. We note, however, that further consideration could be given to the 'balance of harms' test if there is some basis to suggest that the significant practical concerns described above could be overcome.

Our preferred option is that the burden of proof to establish that a merger is anti-competitive should remain with the CMA although further consideration should be given to the suitability of reversing the burden of proof.

106. Under the existing primary merger regime, the CMA (in common with all global competition authorities) has the burden of proving that a merger is anti-competitive. Some commentators have argued that it would generally be more appropriate for the burden of proof to be on the merging parties.[47] Similarly, it has been argued that the current position does not appropriately reflect information asymmetries, with competition authorities requiring data and information from the merging parties to substantiate the theories of harm (which merging parties may have the incentive to provide partially or with delay).

107. Reversing the burden of proof would reallocate this risk, so that transactions would only be cleared where the merging parties provided sufficient proof to establish that a transaction is not likely to give rise to consumer harm. This would reduce the risk of false negatives, resulting in a more cautious approach in mergers, such as those involving potential competition, where evidence on competitive interaction between the firms can be limited. This would also increase the incentive on merging parties to provide evidence to inform the theories of harm raised by the merger.

108. It is not unprecedented for merging parties to bear the burden of proof in some circumstances. For example, in both UK and EU merger control, the burden of proof is placed on merging parties to prove efficiencies, on the basis that these parties are better placed than competition authorities to assess synergies and cost reductions resulting from a transaction.

109. Reversing the burden of proof would, however, be a fundamental change in merger policy involving firms with SMS, under which there would be a high likelihood of the majority of mergers being prohibited. In particular, we currently believe that it would be difficult, in practice, for merging parties to meet this burden in the vast majority of cases (including transactions that do not have a material risk of harming consumers). Moreover, reversing the

[47] See for examples, Motta and Peitz, Challenges for EU Merger Control, Discussion Paper Series (2019), Discussion Paper No. 077, Project B 05 and Tomasso Valletti comments in this GCR article (2018). Reversing the burden of proof was also supported by some respondents to the call for information.

burden of proof would be a particularly restrictive measure, given that it is a well-established principle that a competition authority should bear the burden of proving that a merger is anti-competitive.

110. Accordingly, for the same reasons as set out above in relation to the introduction of the 'balance of harms' test, we believe (consistent with the conclusions of the Furman Review) that this would likely go further than is necessary to address the particular concerns that arise from SMS mergers. As explained further below, we consider that there are more proportionate means available to address the potential limitations that have been identified in the existing primary merger control regime. On this basis, we consider that a reversal of the burden of proof would not appear to be justified.

111. We note again, however, that further consideration could also be given to reversing the burden of proof if there is some basis to suggest that the concerns described above could be overcome.

Competition concerns should be assessed using the SLC test, but to a lower and more cautious standard of proof.

112. As set out above, in order to address the serious risk that acquisitions by firms with SMS that have considerable potential to cause significant harm to UK consumers could be cleared, we support the use of a lower and more cautious standard of proof in the final decision on SMS mergers. This would enable the CMA to intervene in mergers in circumstances where there was a lower probability that the merger would result in an SLC.

113. We therefore propose that a phase 2 investigation under the SMS merger regime would assess whether the merger will give rise to an SLC by applying a threshold that is lower than the 'more likely than not' test. Our recommendation at this point is to assess whether there is a 'realistic prospect' that a merger gives rise to an SLC. This would, critically, enable the CMA to intervene in mergers that have the potential to cause significant harm to UK consumers, even where it cannot be established that this outcome is more likely than not.

114. In principle, the final decision in relation to whether a merger can proceed is taken after an in-depth 'phase 2' investigation.[48] At the end of a phase 2 investigation, the CMA is required to determine whether a merger 'may be expected to result' in an SLC (or 'has resulted' or 'may be expected to result'

[48] Merging parties are also able to offer remedies to address competition concerns identified following an initial phase 1 investigation to avoid a reference to a phase 2 investigation.

in an SLC in a completed merger). The Enterprise Act 2002 does not specify a standard of proof for phase 2 merger inquiries. The CMA takes the approach of applying a 'balance of probabilities' standard, based on case law,[49] as explained in the CMA's Merger Assessment Guidelines.[50]

115. The existing legal standard is well-understood and there is well-established case law to support its interpretation. As explained above, the existing substantive test is broad (so can capture the range of potential harms to competition that could arise in acquisitions by SMS firms) and can accommodate a significant degree of the uncertainty that can characterise digital markets (so that uncertainty about how a market or a target business is likely to evolve does not, in and of itself, provide a bar to intervention where appropriate).

116. There may, however, be circumstances in which there is a material risk that a merger would result in an SLC but it may not be possible to prove this on a 'more likely than not' basis, particularly given the forward-looking analysis that is often required when assessing digital mergers,[51] and therefore the CMA is not able to intervene. While risks of under-enforcement exist in all sectors, the potential impact of a 'false negative' can be more significant in relation to acquisitions by firms with SMS, given the sustained and entrenched market power of those firms, the high number of transactions they enter into, and the potential harms to innovation and the nature of the markets in which they operate.

117. Given these risks, we have considered the potential benefits of applying a lower standard of proof within the SMS merger regime and what that standard of proof might be.

118. The balance of probabilities standard is not used at all stages of CMA investigations. At the end of a phase 1 investigation, the CMA determines whether there is a 'realistic prospect' of an SLC. The Enterprise Act 2002 does not specify a particular threshold in this regard, but states that the CMA must refer a merger for a phase 2 investigation if it believes that it is or 'may' be the case that a merger 'may' be expected to result in an SLC.[52]

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[49] See for example IBA Health Limited v OFT [2004] EWCA Civ 142, paragraph 46.
[50] Merger Assessment Guidelines (2010), paragraph 2.2, and Draft revised guidance: Merger assessment guidelines (2020, currently under consultation), paragraph 2.34.
[51] Some hypothetical scenarios where this risk may arise are set out in Furman Review (2019), Unlocking Digital Competition, paragraphs 3.81-3.82 and footnote 16.
[52] Sections 22 and 33, Enterprise Act 2002.

119. The ‘realistic prospect’ formulation is intended to be shorthand for more complex statutory language (following the Court of Appeal’s judgment in IBA Health Limited v OFT).[53]

120. The test is described in the CMA’s guidance as a ‘reasonable belief, objectively justified by relevant facts, as to whether or not it is or may be the case that the merger has resulted, or may be expected to result, in an SLC’. The guidance further explains that this is a finding at a ‘lower range of probability’ than the balance of probabilities standard, where the ‘relevant likelihood’ of an SLC is ‘greater than fanciful, but below 50%.’[54]

121. The CMA’s guidance further explains that the realistic prospect threshold applied in a phase 1 investigation is ‘intentionally a lower and more cautious threshold for an SLC finding than that applied [in a phase 2 investigation] after more extensive investigation’.[55]

122. Accordingly, while the purpose of using this threshold in a phase 1 investigation – ie to ‘screen’ whether a transaction should be referred to an in-depth investigation – is different to that envisaged in phase 2 investigations under the SMS regime, there would be conceptual consistency in using the same test where a cautious approach is merited for other reasons (ie because of the more acute risks of under-enforcement in relation to acquisitions by firms with SMS). Applying a lower standard of proof would enable the CMA to block mergers in circumstances where there is a lower probability that the merger in question will result in an SLC, reducing the risks of under-enforcement in relation to these transactions.[56] This would be consistent with the central principles underpinning the recommendations in the Furman Review, namely that both the likelihood and potential scale of harm should be taken into account in the assessment of digital mergers, and that authorities

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[53] IBA Health Limited v OFT [2004] EWCA Civ 142.
[54] Merger Assessment Guidelines (2010), paragraphs 2.5 and 2.6, and Draft revised guidance: Merger assessment guidelines (2020, currently under consultation), paragraph 2.31.
[55] Merger Assessment Guidelines (2010), paragraph 2.7, and the Draft revised guidance: Merger assessment guidelines (2020, currently under consultation), paragraph 2.32.
[56] In a recent article, Carl Shapiro argues for the strengthening of US merger enforcement in relation to dominant firms. One of his proposals is to lower the evidentiary requirements necessary to find a substantial lessening of competition based on a loss of potential competition. He considers that this approach would allow more acquisitions by the tech titans involving important inputs or complements to be challenged. He argues that: ‘Under this standard, Facebook’s acquisitions of Instagram and WhatsApp might well have been blocked, if these firms were seen as well placed to mature into rivals to Facebook as social media platforms, and Google’s earlier acquisitions of YouTube and DoubleClick would at least have warranted greater scrutiny. But it seems unlikely that Amazon’s acquisition of Whole Foods or Google’s acquisition of Nest would have raised serious issues even under this stricter standard.’ See Shapiro, Protecting Competition in the American Economy: Merger Control, Tech Titans, Labor Markets (June 2019).

should be able to intervene in transactions even where harm is not the likely outcome.[57]

123. This approach also has the advantage of building upon well-established and understood concepts: the SLC test and the realistic prospect threshold. A merger could be prohibited where it raised conventional competition concerns (ie as a result of unilateral, coordinated or non-horizonal effects), even where it could not be established that this outcome is more likely than not. In addition to being a more robust and transparent test for the CMA to apply in practice, this would arguably help merging parties to self-assess merger control risk when contemplating transactions, as opposed to an alternative test such as the 'balance of harms' (which may be particularly difficult to assess in practice, given the need for a quantitative assessment of all potential harms and benefits that might be raised by a merger).

124. For the avoidance of doubt, the proposed introduction of the 'realistic prospect' standard would not reduce the rigour of an in-depth phase 2 investigation. There would continue to be material differences in the nature of phase 1 and phase 2 investigations, such that the outcome of an initial phase 1 investigation would not prejudge the outcome of a subsequent in-depth phase 2 investigation. In particular:

- while decisions at phase 1 would be taken by senior CMA staff, an independent Inquiry Group would oversee the phase 2 investigation and take the final decision on the substance of the case;
- the phase 2 investigation would be a longer and more intensive process than the phase 1 investigation, which would enable more evidence to be gathered and more analysis to be carried out; and
- in keeping with the current conduct of CMA cases, the phase 2 investigation would provide the merging parties with several additional opportunities to make their case (in person and in writing) to the decision makers (ie the independent Inquiry Group).

125. While we believe that applying a lower standard of proof within the SMS merger regime would have significant benefits, we have also carefully considered the potential drawbacks and unintended consequences of such an approach.

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[57] Furman Review (2019), Unlocking Digital Competition, paragraphs 3.88 and 3.89. This is also consistent with the recommendation in the Lear's (2019) Ex-post Assessment of Merger Control Decisions in Digital Markets, page xiv, which recommends that the CMA should be willing to accept more uncertainty in order to address potential gaps in merger enforcement. A few respondents to the call for information were also supportive of changing the standard of proof.

126. First, there may be concerns that lowering the burden of proof would result in less investigative rigour being applied in phase 2 investigations (given that the realistic prospect is currently applied after an initial phase 1 investigation rather than after an in-depth phase 2 investigation).

127. We consider, however, that such concerns are not warranted. It would be made clear (in the applicable legislation and guidance) that an in-depth investigation would still be conducted at phase 2. The legislation and guidance would 'lock in' key aspects of the phase 2 process, including the appointment of a new and independent set of decision-makers to consider the applicable statutory questions and the applicable statutory timeline for investigation. Accordingly, the decision at phase 2 would typically be informed by a significantly more developed evidence base.

128. Second, there may be concerns that using the realistic prospect test for different purposes (ie for assessing whether an acquisition by an SMS firm raises competition concerns following an in-depth investigation or whether an acquisition by another firm should be referred to an in-depth investigation) could result in confusion or inconsistency.

129. Again, we believe that such concerns should not be overstated and can be addressed through clear guidance. The applicable tests are relatively broad in nature, as there are a variety of circumstances in which an SLC can arise, and any merger investigation is fact-specific. In practice, the same standard of proof (whether it is realistic prospect or balance of probabilities) is applied in a variety of different circumstances and proceedings and on a case-by-case basis. As noted above, the fact that the realistic prospect standard is already used in UK merger control is likely to be useful, as decision makers and merging parties already have some understanding of how this standard is likely to apply in practice and its interpretation has already been considered by the UK Courts.

130. Finally, we have considered whether the use of the realistic prospect test for mergers involving firms with SMS could undermine the effectiveness of the existing primary merger regime in any way. For example, if applying a lower standard of proof is considered to be one of the ways in which uncertainty can be accommodated within merger assessment, there could be a risk that this could lead to a bias against intervention in other sectors where the balance of probabilities standard is applied.

131. Ultimately, this risk can be mitigated by continuing to run the existing primary merger regime in an appropriate way. In particular, the revised version of the CMA's Merger Assessment Guidelines makes clear that the fact that there may be some uncertainty in how the market is likely to develop in the future

does not,[58] by itself, reduce the likelihood that a merger could give rise to competition concerns, and the presence of some uncertainty therefore does not in itself preclude the CMA from finding competition concerns on the basis of all the available evidence.

Conclusion

132. For the reasons explained above, our preferred option is that the SMS merger control regime continues to use the ‘SLC’ test with the standard of proof at phase 2 lowered from ‘balance of probabilities’ to ‘realistic prospect’. This would, critically, enable the CMA to intervene in mergers that have the potential to cause significant harm to UK consumers, even where it cannot be established that this outcome is more likely than not.

133. We believe that this would be a proportionate response to the risks of under-enforcement (in light of the available evidence about the nature and extent of under-enforcement in digital markets) and our view that the existing framework for assessment (in particular the existing substantive test) remains largely fit-for-purpose. This approach would also have the benefit of using well-established and understood concepts – the SLC test and the realistic prospect threshold – in order to support the predictability and transparency of UK merger control.

We recommend that non-competition concerns in mergers would continue to be assessed by other regulators under existing frameworks, including intervention on public interest grounds, with cooperation mechanisms being strengthened. Further consideration is needed on how to address media plurality concerns not covered by existing public interest frameworks.

134. The public policy concerns that are raised by acquisitions by SMS firms are not always limited to competition issues. For example, mergers could have privacy implications or wider public interest concerns similar to those in media mergers.

Privacy and data protection

135. Some privacy and data protection concerns fall to be considered as competition-related concerns under the existing primary merger control regime. For example, the CMA can take privacy protection into account as a non-price factor of competition in horizontal mergers and can also assess

[58] Draft revised guidance: Merger assessment guidelines (2020, currently under consultation).

acquisitions of data as part of a foreclosure theory of harm in non-horizontal mergers.

136. There may, however, be potential harms that arise from acquisitions by SMS firms that are not related to competition. For example, the acquisition by a firm of a target in a wholly unrelated market (ie without any vertical, horizontal or conglomerate links), but with a valuable dataset, would most likely not raise competition concerns, but could give rise to consumer harm as a result of privacy protection concerns.

137. In particular, the combination of previously independent datasets could lead to a decrease in privacy protection of the customers of at least one of the two merging firms (eg by having the two entities align their privacy policies). Furthermore, it may also be possible for the merged entity to profile consumers to a greater extent than it would have been possible in the absence of the merger by integrating a target's dataset with its own.[59] To the extent that such concerns do not relate to competition, these harms are not considered within the existing primary merger control regime operated by the CMA, as the remit of the CMA, by law, is limited to the assessment of the impact of a transaction on competition.

138. The ICO, the UK's data protection and e-privacy regulator, currently has the ability to intervene in and improve the information rights practices of organisations. In this context, the ICO is able to take enforcement action against firms that breach the applicable legislative data protection and e-privacy protection obligations. In the most serious of cases, the ICO can serve monetary penalties of up to €20 million or 4% of annual worldwide turnover (whichever is higher). Under the Data Protection Act 2018, the ICO has a range of regulatory tools available to it, including the power to issue an enforcement notice requiring a party to stop processing personal data where that party is failing or has failed to comply with data protection requirements (including potentially in the context of the combination of two datasets arising from a merger).

139. Data controllers must also prepare Data Protection Impact Assessments (DPIAs) when planning to begin any type of processing that is likely to result in a high risk to the rights and freedoms of individuals with obligations to engage in prior consultation with the ICO in certain circumstances. The ICO can also take action on its own initiative in accordance with its Regulatory Action Policy. For example, in 2016, under the then-applicable data protection statute (the Data Protection Act 1998) the ICO intervened in relation to

[59] CCP response to Call for information on digital mergers, page 12-13.

Facebook's post-merger data sharing plans with WhatsApp and secured a voluntary undertaking from WhatsApp that, among other matters, it would not transfer any WhatsApp EU user data to Facebook on a controller to controller basis prior to the EU General Data Protection Regulation (the GDPR) coming into force and that it would comply fully with the GDPR upon commencement of any controller to controller personal data transfer obligations.

140. More generally, the ICO can become aware of a notified merger through information sharing with the CMA (as proposed below), through its own intelligence gathering or where a data controller is required to consult with the ICO because its DPIA identifies residual high risk in relation to the merger. Where the ICO is satisfied that personal data processing resulting from a merger is likely to infringe data protection law, it can issue a warning to a data controller or processor. If this warning is not complied with, the ICO has the power to issue an enforcement notice which can, at its discretion, include a temporary or definitive limitation on processing.

141. The ICO therefore already has significant powers to intervene in relation to the processing of personal data, including any non-compliant combination of personal datasets. We are satisfied that it has the powers required, as outlined above, to be able to enforce as necessary. We have therefore not seen any basis to indicate that acquisitions by firms with SMS should be subject to a separate mandatory and suspensory review on the basis of e-privacy or other data protection concerns.

Public interest interventions and media plurality

142. Mergers involving firms with SMS may also give rise to concerns that may not be capable of being addressed within the existing bases for public interest interventions in merger cases. As UK consumers increasingly use online platforms to access content, SMS firms may play an increasingly important role in terms of media plurality in the UK. As a result, where an SMS firm is operating as an intermediary between the media and UK consumers there is the potential for mergers involving these firms to raise media plurality concerns.

143. The Enterprise Act 2002 enables the Secretary of State to intervene in a merger on public interest grounds, including certain media plurality considerations.[60] Under the existing regime, the Secretary of State can direct Ofcom to advise on the potential impact of media mergers involving a

[60] Sections 42 and 58 of the Enterprise Act 2002.

'broadcaster'[61] or 'newspaper enterprise' on media plurality. The Secretary of State also has the power to specify additional grounds on which to intervene in a merger.[62] Following an intervention on media plurality grounds, the CMA and Ofcom act as advisory bodies, with the ultimate decision-making power on the public interest test resting with the Secretary of State. The competition assessment is conducted by the CMA, and the Secretary of State is bound by its decision.

144. Ofcom has previously identified several limitations of the current media plurality public interest grounds, particularly pointing to the changing media landscape as consumers increasingly access media online.[63] Some of these challenges may also apply in the context of media plurality concerns that could arise from mergers involving SMS firms.

145. For example, if a merger gives the firm a financial incentive to demote rival media when it curates content for its users (ie equivalent to self-preferencing), this may reduce exposure to, and therefore the consumption of, a plurality of media sources below desired levels. In addition, a merger between two digital firms which UK consumers use to access and consume online content may raise concerns that the merged entity has too much influence over the formation of public opinion and the political process, potentially reducing consumption of a plurality of views below desired levels. Depending on the nature of the transaction, these concerns may not be capable of being addressed within the existing public interest grounds, if a merger involving SMS firms does not also involve 'broadcasters' or 'newspaper enterprises'. More work is needed to establish whether such concerns are better addressed through an updating of the media plurality framework in general or through the distinct SMS merger control regime.

146. In the meantime, we consider that there is likely to be value in applying the existing public interest intervention regime to the SMS merger control regime, allowing the Secretary of State to intervene in these mergers on public interest grounds where the relevant statutory tests are met in the same way as under the existing primary UK merger control regime.

[61] A 'broadcaster' is defined in terms of holding a broadcast licence under the Broadcasting Act 1990 or Broadcasting Act 1996. The person needing a licence for a broadcast service is the person with editorial control over it (Article 1 Audiovisual Media Services Directive).
[62] Section 58(3) of the Enterprise Act 2002.
[63] For example, paragraphs 1.10-1.12. Ofcom, The operation of the media ownership rules listed under Section 391 of Communications Act 2003 (2018).

Enhanced cooperation

147. It will be important to ensure that the SMS merger control regime enables sufficient cooperation between the different regulators that may be considering the different implications of the same transaction. Building on the recommendations around information sharing set out in the advice more generally, the SMS merger control regime should therefore explicitly provide for the sharing of information between the CMA and other authorities where appropriate, and the CMA, Ofcom and the ICO should cooperate on individual cases through information exchange, consultation and other forms of close cooperation.

148. The use of a mandatory and suspensory merger control regime would help with this cooperation, as it would allow time for all relevant regulators to have access to information and consider the need for intervention prior to the closing of the transaction. This would allow the regulators to be aware of the occasions where SMS mergers examined by the CMA on competition grounds may also raise concerns in relation to media plurality or privacy and data protection, and to cooperate closely where the ICO's and Ofcom's expertise can assist the CMA when assessing particular mergers. In addition, it would provide the ICO with sufficient information for it to decide if it wishes to intervene prior to any data being shared between the two firms.

149. While we do not rule out that non-competition concerns should be assessed in a more formal manner as part of the SMS merger control regime at some stage, separately from the existing frameworks for assessment described above, the design and timing of such a regime would require further detailed consideration. The proposed approach would allow all regulators to refine the use of their respective powers in tandem in the context of a merger review and for each to become better acquainted with the types of non-competition concerns raised by acquisitions by firms with SMS.