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AlixPartners

RESPONSE TO CMA CONSULTATION – PROPOSED REVISIONS TO THE CMA'S MERGER ASSESSMENT GUIDELINES

1 Introduction

1.1 AlixPartners is a global consulting firm that assists clients with merger control proceedings in the UK and globally. In particular, AlixPartners has extensive experience of submitting economic analysis to competition authorities globally, and of assisting clients with forensic evidence gathering and e-discovery in merger control inquiries. AlixPartners' wider consulting business also assists in merger investigations by providing market expertise, by assessing whether firms are failing from a turnaround and restructuring expert's perspective, and by quantifying merger efficiencies. AlixPartners regularly assists clients in both Phase 1 and Phase 2 merger inquiries.

1.2 Addleshaw Goddard is a London headquartered global law firm which advises a range of clients on merger control in multiple jurisdictions. Addleshaw Goddard has particular experience in advising clients on UK merger control. Addleshaw Goddard acts on a range of merger control matters from initial advice, briefing papers to the Mergers Intelligence Unit, Phase 1 investigations, Phase 2 investigations, cases with remedies and appeals to the Competition Appeal Tribunal and Courts.

1.3 AlixPartners and Addleshaw Goddard welcome the opportunity to respond to the CMA's consultation on revisions to the CMA's Substantive Assessment Guidelines ("The Revised Guidelines"), which were last issued over ten years ago. These Revised Guidelines are well written and have much to commend them,[1] and we thus break down our comments into three broad headings. (We have not sought to comment comprehensively on the Revised Guidelines).

1.4 First, whilst the Guidelines are comprehensive in many respects, there are some noteworthy topics that are not covered in any detail and where guidance would be helpful since these are issues that have arisen in a number of cases. Specific additional topics that the CMA should consider adding to the Revised Guidelines include:

(a) the appropriate ways of calculating market shares;[2]

(b) the CMA's assessment of mergers in bidding and negotiation markets, which raise different issues to mergers in differentiated goods/services markets or in purely homogeneous goods markets;[3]

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[1] For example, it is welcome that the CMA refers to a range of cases in the Revised Guidelines. It would be helpful if paragraph references could be added to the key detailed text so that the detailed evidence can readily be found, and adding more case references would be helpful. (Finding specific issue references in CMA decisions is difficult from the CMA's website as it has limited search functionality.) Some minor updating of cases references will be appropriate in the final version of the Revised Guidelines (for example, in footnote 107 the CMA refers to its Phase 1 reference decision in Yorkshire Purchasing Organisation/Findel and aspects of its assessment of coordinated effects, whereas in its provisional findings the CMA provisionally ruled out coordinated effects). More generally, the CMA might wish to focus its case references to where it has issued final reports at Phase 2 cases (rather than mergers that are abandoned at the provisional findings stage as these will not reflect final evidence from the parties and third parties), with Phase 1 cases being referred to where these were the final decision on a merger (i.e. the merger was either subsequently abandoned or undertakings in lieu of reference were agreed).

[2] For example, the Revised Guidelines attach considerable weight to market shares, and it would thus be helpful if the Revised Guidelines consider the factors that are relevant to the CMA's choices between various bases on which market shares are assessed, such as installed base (which might reflect historic sales, not current sales), revenues from new sales (which may be complex if some competitors sell equipment outright and some lease), and whether market shares should in some cases be based on average sales over a number of years (so as to average out large "lumpy" sales orders). These issues are addressed by the CMA, for example, in its Phase 1 decision in Inspired/Novomatic.

[3] For example, as considered in Tradebe/Sita, Alpha Flight Group/Lufthansa, and Xchanging/Agencyport.

(c) customer markets and price discrimination, where the adverse effects may relate to specific customers being discriminated against;[4]

(d) excessive buyer power;[5] and

(e) the competitive effects of minority shareholdings and successive acquisitions of further control from material influence.[6]

1.5 Second, there would be merit in the CMA considering whether it has struck the right tone and balance across the Revised Guidelines as a whole *and* whether more clarity can be given as to the circumstances where competition concerns are unlikely to arise along with potentially relevant exculpatory evidence. In particular, the Revised Guidelines emphasise that the CMA may choose to limit its investigation and quantification of the facts, are substantially more interventionist (due to the factors they identify as prima facie evidence of harm and by dismissing or downplaying certain countervailing factors), and exclude any references to any "safe" harbours as regards market shares or number of competitors or other matters that are exculpatory (even expressed in likelihood terms, and without prejudice to the CMA reaching an adverse finding based on other evidence or considerations). These issues warrant careful consideration, and further comments are set out in Section 2 below.

1.6 Third, the Revised Guidelines make extensive references to the CMA relying on the parties' internal documents. The parties' internal documents are clearly relevant information, but it is important to note that there may be material limitations to basing economic effects analysis on such documents and unintended evidential biases as a result of the documents that the CMA reviews, which are predominantly those of the merging parties. This is discussed further in Section 3 below.

2 The overall balance of the Revised Guidelines

2.1 There are a number of aspects of the Revised Guidelines where the CMA may wish to consider the overall balance of the Guidelines, which are considerably more interventionist and, in many respects, give limited guidance as to the key evidence required to assess and potentially refute various theories of harm. **At the outset, it is important to be clear that the points being made below are ones of tone and balance – we are not seeking to suggest that the CMA should not raise these issues or explore the factual evidence carefully – but that in the context of guidelines tone and balance matter.**

Is there a general basis for UK merger control to be more interventionist?

2.2 The CMA frames its discussion of the Revised Guidelines by suggesting that there has been under enforcement of merger control. This is raised particularly in relation to digital markets (specifically noting that the five largest digital firms have made over 400 acquisitions in the last ten years),[7] as certain US economists have suggested that there may have been under

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[4] There may be customer specific markets where the effects of the merger vary across different customer groups, because it is possible to price discriminate between different customers. (This is discussed in the 2010 Guidelines at paragraphs 5.2.28-5.2.31). For example, in Unite/Liberty the CMA considered the competitive effects of the merger centred around individual higher education institutions (i.e. sources of customer demand, with the CMA considering that students value living nearby).

[5] For example, as considered in Tesco/Booker and European Metal Recycling/Metal & Waste Recycling. Excessive buyer power is discussed in the 2010 Guidelines at paragraphs 5.4.19-5.4.21.

[6] For example, as were considered by the CMA in Hunter Douglas/247 and Amazon/Deliveroo.

[7] Paragraphs 1.7-1.8 of the Revised Guidelines. The Lear report is a well written document that makes a range of important points, and this report is critical of the CMA's analysis in some cases (particularly Facebook/Instagram and

enforcement as regards coordinated effects[8] and that there are risks of under enforcement as regards vertical mergers (and the CMA's Digital Advertising market study expressed concerns about certain vertical acquisitions by Google).[9]

2.3 However, in our view, these statements do not provide any substantive evidence base for making UK merger control more interventionist across the UK economy. As regards digital markets, the focus of investigations globally and in the UK have been on the largest digital companies. As a result, the CMA is proposing a new merger control regime for such companies, including that their mergers will be required to be pre-notified and assessed at Phase 2 on the basis of whether there is "a realistic prospect" of a SLC (which is a low bar for intervention).

2.4 This would not seem to justify a presumption that there has been under enforcement of all digital mergers. In particular, a view that certain, very large-scale digital markets may be prone to "tipping", or otherwise being predominantly supplied by one firm, is no basis for presuming this across all digital markets or indeed demonstrating that such tipping is due to mergers.

2.5 To make a major policy change, it is necessary to robustly consider the evidence and in a UK merger control context. This does not seem to have been done. For example, the CMA makes selected references to articles by some US economists, rather than conducting a full review of consensus thinking on these subjects. This does not provide a robust basis for changes to UK merger control. In this regard, it is also important to bear in mind that US merger control operates in an entirely different legal and administrative environment, including as regards legal standards, the independence of the agencies, and processes that require the US agencies to go to court to block a merger.

What is the role of merger guidelines and their treatment of economic evidence?

2.6 The CMA's Revised Guidelines raise a variety of issues as regards the role of merger guidelines and the CMA's treatment of economic evidence. To put these issues in context, it is appropriate to make three general points as to the appropriate objectives for merger control assessments and the purpose of issuing guidelines.

2.7 First, the Revised Guidelines rightly emphasise that the fundamental purpose of UK merger control is to safeguard the interests of consumers – and customers more generally. [10] This focus on consumers also underpins the CMA's assessment of theories of harm across various types of mergers, which should explain *how* mergers may reduce rivalry by creating or enhancing market power and *how* exercising this market power will harm consumers in some tangible way, whether in terms of price or any other dimension of competition.

2.8 Second, the Revised Guidelines also rightly emphasise that it is "crucial" that appropriate guidance is provided to firms contemplating transactions.[11] This is particularly important for small- and medium-sized business, which are the focus of many of the CMA's merger inquiries. Merger inquiries, in particular at Phase 2, are in themselves increasingly resource intensive for the parties and a failed transaction can cause businesses substantial harm in terms of foregone opportunities and management resources.

Google/Waze). However, this review of cases does not establish that the same issues would have arisen in all digital markets, particularly given the market positions of Facebook and Google.

8 Paragraph 6.5 of the Revised Guidelines, with footnote 102 referring to two articles.

9 Paragraph 7.6 of the Revised Guidelines, with footnote 110 referring to two articles.

10 Paragraph 1.3 of the Revised Guidelines.

11 Paragraph 1.3 of the Revised Guidelines.

2.9 The application of UK merger control will have a deterrent effect – i.e. deterring transactions that might be perceived as potentially anti-competitive - and merger control risks are a material consideration, particularly given the substantial advisor costs, management time and CMA fees and delays to completion (including businesses being held separate) that will need to be faced through extensive merger control reviews. As a matter of policy, the CMA and the Government will no doubt not wish to inadvertently deter pro-competitive or competitively neutral mergers. This is perhaps particularly the case currently as COVID and any recessionary pressures may make restructuring commercially important for the long-term survival and health of many businesses.

2.10 These considerations thus create an imperative for guidelines to provide clear guidance on both what constitutes a credible theory of harm that is well founded in robust economic theory, and *also* the key evidence required to assess these theories of harm *and* the circumstances in which they are more or less likely to apply. This is the fundamental purpose of any merger guidelines, namely to highlight the range of economic and factual issues that may need to be assessed to analyse whether a specific merger may lead to a SLC.

2.11 Third, in order to arrive at balanced decisions there needs to be a thorough factual investigation, so that competing economic theories can be accepted or rejected to the requisite legal standard. The CMA is well placed to do this as it is a large and sophisticated competition authority that employs many economists, and which carries out lengthy Phase 1 and Phase 2 investigations over which it requires the merging parties to provide extensive information.[12]

2.12 We presume that the above points are uncontroversial. However, the CMA makes a number of points as to its gathering and assessment of evidence as to the existence of an SLC, which in our view risk compromising these objectives. In particular, the Revised Guidelines emphasise that:

(a) there is no need to engage in an exact measurement of an SLC.[13] At one level, this is a reasonable statement. However, it would be welcome if the CMA were to emphasise that it will nonetheless seek to confirm that there is some tangible harm to consumers and in many cases it will seek to apply quantitative techniques where the data is available, particularly where this may help weigh up competing arguments and offsetting factors. This would seem particularly appropriate in detailed Phase 2 investigations where there is a very significant and increasing requirement for the production of evidence from the merging parties and third parties;

(b) there is no higher evidential burden for specific theories of harm.[14] Again, this a reasonable statement. However, it would be helpful if the CMA were to explicitly state that where the underlying theory of harm is more complex *and* there is more uncertainty existing as to whether each of the various conditions are satisfied for this theory of harm to apply, then it is appropriate to have regard to whether "the probability of all of the necessary elements being present would be lower than the probability of each element individually".[15] The quoted statement was made by the CMA in the context of its Phase 2 investigation of BT/EE, where the main theories of harm were vertical. (It is not

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12 For example, the CMA's Annual Report and Account for 2019/20 indicated that its income amounted to £112.9 million and it levied merger fees of £5.5 million.

13 Paragraph 2.7 of the Revised Guidelines.

14 Paragraph 2.10 of the Revised Guidelines.

15 BT/EE, paragraph 13.

suggested that this means that complex theories of harm cannot apply, but simply that the CMA needs to weigh up the evidence carefully.); and

(c) where the "prima facie" evidence of competition concerns is "stronger, especially where there is little evidence to the contrary, at an early stage, the CMA will expect to undertake less detailed analysis in deciding whether there is an SLC".[16] In a similar vein, the Revised Guidelines emphasise that, in the context of appeal of CMA merger decisions, the CAT has stated "that it will not intervene merely because it considers that further inquiries would have been desirable or sensible".[17] The difficulty with these statements – perhaps particularly in the context of detailed Phase 2 inquiries – is that they suggest that the CMA's focus is not in carrying out a thorough investigation of the facts and with an open mind. This is no doubt unintentional, and thus the CMA may wish to consider whether these statements should be re-worded. For example, why would the CMA not wish to carry out further inquiries if they are "desirable or sensible", even if a failure to do so would not lead to a successful appeal (reflecting the very limited review of economic evidence by the CAT in appeals of mergers), particularly in circumstances where it has required the merging parties to produce substantial, detailed information that would support such analysis? Moreover, there is an obvious risk of prejudice and confirmation bias if the CMA makes decisions on cases at "an early stage" prior to carrying out a full investigation. Our experience as advisors is that our factual investigations always reveal valuable information, and sometimes surprising information that overturn our initial thinking. For example, the parties' internal documents may contain statements suggesting that a merger is highly problematic, but these may be entirely contradicted by the actual facts (more on this later).

What is prima facie evidence of an SLC and what is exculpatory evidence?

2.13 Further issues arise due to the factors that the Revised Guidelines appear to regard as "prima facie" evidence of the existence of an SLC, and matters that are not likely to be exculpatory evidence of countervailing factors or factors that might otherwise mean that there is not an SLC.[18] For example:

(a) In the context of assessing unilateral effects in differentiated goods markets, the Revised Guidelines states that:

"The smaller the number of significant players, the stronger the prima facie expectation that any two firms are close competitors, and therefore the less detailed analysis is necessary to further assess closeness between them."[19]

"Even where the boundaries of the market are unclear, the CMA may use shares of supply to compare the relative popularity or scale of two or more firms, which may provide evidence on closeness."[20]

Both of these statements raise issues. The CMA appears to be suggesting that prima facie evidence of a SLC can be found in relation to any merger in a differentiated market that reduces the number of significant competitors. Taken to its logical conclusion, this would suggest that merger control analysis in 2021 can be reduced to a static market share analysis. These concerns are increased by the further statement indicating that

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16 Paragraph 2.18 of the Revised Guidelines.
17 Paragraph 2.18 of the Revised Guidelines.
18 These examples are not intended to be a comprehensive list.
19 Paragraph 4.9 of the Revised Guidelines.
20 Paragraph 4.13 of the Revised Guidelines.

the CMA may be willing to rely on shares of supply to infer that firms are close rivals "[e]ven where the boundaries of the market are unclear", with the logical consequence that there might be substantial diversion outside the relevant market. We have no per se objections to the CMA de-emphasising market definition in its assessment of competitive effects (as done in Section 9 of the Revised Guidelines), but this raises real risks if this leads to a failure to assess and quantify out of market constraints that may collectively be an important constraint on the merged business. It is also at odds with the demands for information that the CMA places on the merging parties.

(b) At various places in the Revised Guidelines, the CMA makes various statements along the following lines:

"While the focus of the CMA's assessment is on the change in the competitive constraints on the merger firms arising from the merger, evidence of pre-existing market power may mean that any given reduction in competitive constraints may be more significant. Where one merger firm has a strong position in the market, even small increments in market power may give rise to competition concerns."[21]

This statement is inconsistent with the CAT's judgment in *Celisio v Office of Fair Trading*:

"We do not accept Celesio's submission that when competition in a particular market is weak this perceived lack of competition makes any further reduction resulting from the merger more serious and thus should have led to more careful scrutiny by the OFT in the present case of the 4 to 3 areas. We consider that the focus should be on the loss of competition, if any, which may be expected to result from the merger."

The relevant question – and consistent with the points made above made in the Revised Guidelines as to the consumer focus of UK merger control – which the CMA needs to address is why, as a matter of fact, the loss of a small competitor is likely to cause tangible consumer harm. Even where there is substantial pre-existing market power, this may not be a concern if the rival does not constrain or prevent the exercise of that market power.[22]

(c) In the context of commenting on the risk of anti-competitive input foreclosure, the Revised Guidelines state that:

"The CMA's assessment of the ability of the merged entity to foreclose its rivals is unlikely to place material weight on contractual protections, for example, to continue supplying both the current version and future upgrades of the input. In practice, such contracts may not completely remove a firm's ability to harm its rivals, given that certain rivals might not be covered by these contracts, the contracts might not protect all ways in which the competitiveness of rivals could be harmed, and the contracts may be of limited duration. Moreover, over time contracts may be renegotiated or terminated, and firms may waive their rights to enforce any breaches in light of their overall bargaining position (reflecting the change in market structure brought about by a merger).

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21 Paragraph 4.14(a) of the Revised Guidelines.

22 Paragraph 175 of *Celesio v Office of Fair Trading.*

However, the CMA may consider any financial or reputational costs of terminating contracts in its assessment of foreclosure incentives."[23]

It is clearly legitimate for the CMA to consider whether, on the facts, existing contracts are incomplete and do not perfectly protect customers. However, even in this scenario, the CMA would need to assess whether the input supplier would have the ability to engage in appreciable input foreclosure within the constraints of an imperfect contract - and then whether the merging parties' would have incentives to adopt such a policy and whether this would have appreciable anti-competitive effects.

As importantly, the CMA advances no evidence whatsoever that the generally appropriate course is to ignore such contracts, and indeed it is surprising for a competition authority to express such conclusions outside its area of expertise on contract law. On the contrary, our experience is that considerable effort is expended by the parties and their lawyers in drafting long term contracts, reflecting that the entire purpose of such contracts is to facilitate long-term relationship specific investments that are mutually beneficial. Such contracts may also include arbitration/mediation clauses and incentives for performance. In addition, within the scope of the contract, poor performance by the supplier of an input might lead to retaliatory poor performance by the customer. Reputational issues are also of crucial importance: other customers, including in unrelated markets, are likely to be deterred from entering into long-term contracts with input suppliers which do not adhere to the spirit of long-term agreements.

(d) In the context of the exiting firm scenario, the Revised Guidelines state that:

"Where there are multiple alternative purchasers, including one or more which is not active in the same markets as the exiting firm, the CMA will normally consider the most likely counterfactual to involve the target being under independent ownership that maintains (or, in some instances, increases) the competitive constraint of the exiting firm."

There may be merit in re-wording this paragraph – if the highest bidder would use the assets outside of the relevant market, it would not seem reasonable to assume that the assets would instead be used in the market.[24]

(e) In the context of commenting on countervailing buyer power, the Revised Guidelines state that:

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23 Paragraph 7.14 of the Revised Guidelines. Similar considerations may apply to long term contracts with customers more generally and thus whether such contracts protect customers supplied under these contracts from adverse unilateral or coordinated effects.

24 In assessing whether there are alternative less anti-competitive purchasers, the CMA's Revised Guidelines indicates that such purchasers only need to be willing to pay more than the liquidation value, namely the value of the underlying assets if they were to be sold for use outside the relevant market. However, it should be noted that in some cases the underlying assets may be valuable in other uses, such that the liquidation value may be material. For example, in its Phase 1 decision in East Coast Buses/First Scotland East, the CMA found that internal documents showed that, before any prospect of a sale to East Coast Buses, First Scotland East had planned to close the target business, and it had taken active steps to close and progress the sale of the bus depots used to a property developer. The CMA further accepted that although there was no formal marketing of the business, its proposed closure was actively publicised, such that any less anti-competitive purchasers could have emerged. One other bus operator had made an offer, but this was well below the liquidation value of the acquired assets. The CMA also noted that another operator had indicated it was not aware of the possibility of buying the business or its assets and it might have made a partial offer, but the CMA concluded that there was not a realistic prospect of such an offer above liquidation value for the use of the assets outside the relevant market.

"Most other forms of buyer power that do not result in new entry– for example, buyer power based on a customer's size, sophistication, or ability to switch easily – are unlikely to prevent an SLC that would otherwise arise from the elimination of competition between the merger firms. This is because a customer's buyer power depends on the availability of good alternatives they can switch to, which in the context of an SLC will have been reduced. In that sense, market power and buyer power are two sides of the same coin, and an SLC can be interpreted as a substantial lessening of customers' buyer power."[25]

This is a problematic statement in so far as it seeks to be a generalisation as to the economics of bargaining between suppliers and buyers, with such economic analysis being essential for any assessment of whether there is an SLC in markets where suppliers bargain with buyers. Key driver of buyers' bargaining power, and thus the existence of an SLC, are their ability and incentives to switch to outside options (i.e. alternative sources of supply). Buyers who can credibly threaten to switch to alternatives, including those outside the market, are *not* dependent on their suppliers. In this context, a merger may reduce the number of existing suppliers to various customers, but this does not answer the relevant question of whether that customer has outside options to which it can switch easily. If it can, "a reduction in the number of good alternatives they can switch to" may make no difference to its buyer power, contrary to the statement made in the Revised Guidelines. Moreover, it is also important to recognise that even large suppliers' outside options may be very poor where they are dependent on large customers, because finding alternative customers or sales channels may be impossible. The sophistication of buyers is similarly highly relevant as this can affect their actual incentives and ability to switch to alternatives. Dynamic competition, which the Revised Guidelines reasonably emphasise more strongly than in the past, is just as relevant in considering the extent and existence of buyer power as it is in considering counterfactuals.

(f) In the context of commenting on barriers to entry and expansion, the Revised Guidelines state that:

"The CMA considers that entry and/or expansion preventing an SLC from arising would be rare. The CMA's evaluation of its past cases has shown that in some instances, when it has relied on entry or expansion to clear mergers, that entry or expansion did not in fact materialise."[26]

We would suggest that the CMA should not prejudge this issue. The fact that entry has not occurred in all cases where it was expected does not mean that the CMA's clearance decision was mistaken based on the evidence available. This is for two reasons. First, precisely the same (but opposite) point applies in cases where the CMA found an SLC in some cases but then (unanticipated) material entry and expansion occurred. The test for the CMA is not perfect foresight, which the CMA emphasises at some length in its assessments of the theories of harm based on the loss of potential competition – this point applies to countervailing entry and expansion as well.

Second, the legal test for the CMA at Phase 2 is based on an expectation of an SLC – and thus by definition the CMA should clear some mergers where an SLC nevertheless

[25] Paragraph 4.19 of the Revised Guidelines.

[26] Paragraph 8.26 of the Revised Guidelines.

materialises. If this were never the case, this would indicate that the CMA is not correctly applying the legal test, but being far too cautious.

2.14 Finally, it is striking that the Revised Guidelines expressly state that it applies no thresholds to assess whether a merger leads to a SLC, such as market shares or number of competitors.[27] The CMA has also chosen to delete all similar guidance as to whether competition concerns are likely based on market structure or the nature of the competition concerns. For example, it has deleted the references to competition concerns being less likely to arise in undifferentiated markets where market shares are below 40% and to most non-horizontal mergers being "benign". We do not consider that such likelihood statements fetter the CMA's discretion to reach adverse findings based on the facts, and their omission compromises the value of issuing guidance. We would thus welcome the CMA adding some carefully worded statements suggesting where concerns are more likely, whilst making it clear that on the facts issues may still arise.

3 Internal documents

3.1 The CMA's Revised Guidelines make very extensive references to relying on the parties' internal documents to assess whether there is a SLC. For example, the Guidelines note that:

> "..the CMA has increasingly interrogated the merger firms' internal documents as a part of its merger investigations and has more closely scrutinised evidence on deal valuation, for example when considering losses of actual and potential competition or when seeking to understand the rationale for and synergies arising from mergers."[28]

3.2 However, there are number of points that should be noted about internal documents, which should temper over reliance on such documents in isolation. In addition, third party submissions and their internal documents should similarly be subject to careful scrutiny.

The context to internal documents is of crucial importance

3.3 It is worth starting by repeating an overarching comment made in our response to the updates to the CMA's mergers procedural guidelines, which emphasises that the parties' views should be sought on such documents:

"The CMA rightly focuses on merger parties' internal documents in its investigations but whilst these can be strong evidence of merger parties' thinking, these must be viewed in their proper context. Often they have a specific purpose and at other times have been drafted without the depth of thought (or supporting evidence) that the CMA credits them with. Whilst the CMA does treat these as only one strand of evidence, merger parties can be frustrated that the process does not allow them to assist the CMA in understanding these documents fully or to produce other evidence of action that explain why the statements in the documents are misleading or should not be interpreted out of context (including by reference to whet her they were used for decision making and by reference to other documents that may be contradictory). In both Phase 1 and Phase 2 investigations, the conclusions drawn from internal documents are presented at a late stage providing merger parties with very limited time to assist the CMA further."

3.4 In addition, part of understanding the context of documents is understanding how businesses record or consider competitive or market intelligence, who produces these documents and who

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27 Paragraph 2.8 of the Revised Guidelines. This is in contrast to the guidance expressed in likelihood terms that is provided at paragraph 5.3.5 of the 2010 Guidelines.

28 Paragraph 2.23 of the Revised Guidelines.

in management teams receives (or received) these documents. (This should also inform whose documents are reviewed to consider who is likely to hold responsive internal documents.) In this regard, the Revised Guidelines make the good point that the absence of certain documents – such as on rivalry between firms – may not be probative if these are not produced in the ordinary course of business or have been deleted.[29] However, the importance of understanding context applies equally to the documents that are produced.

3.5 A further key context point is understanding - if and how – internal documents either properly record actual decision making or have actually been implemented in practice. In short, actions speak louder than words. In our experience, internal documents often set out decisions or policy statements, indicating that a particular course of conduct will be followed (such as increasing prices), but then no such price rises may be implemented in practice. Accordingly, internal documents may often need to be linked to factual structured information as to what actually happens (e.g. transactional records), since there can be a real gap between such statements and actual business decision making.

Third parties' views should be tested as well

3.6 It is not disputed that internal documents often set out views on the market or rivalry that can provide a valuable counterpoint to test alternative views expressed by the merging parties in their submissions to the CMA. The same point applies to third party submissions, and thus the CMA should closely scrutinise the evidential base for their views as well. The substantive point as regards the parties' and third parties' views is the existence or absence of supporting factual evidence. For example, customers' stated views on competitive alternatives to the parties' products or services might not tally with their recent purchasing decisions or reflect their perceptions when they last revisited their choice of suppliers, rather than the current competitive position.

3.7 Further, in seeking to understand likely counterfactuals for the market as a whole there are inherent biases in looking at the perspective of the merging parties as set out in internal documents, without also considering what the contemporaneous plans of others might be.[30]

Internal documents may not be an accurate guide to the underlying facts

3.8 In considering the evidential value of internal documents, it is important to appreciate that internal documents are often based on an incomplete knowledge of the market, including firms' monitoring of their rivals. Firms often have limited visibility on rivals' conduct, large rivals tend to be more visible as they have more customers, larger facilities and may report more information (such as on their websites or in financial and management reports), and market intelligence tends to be backward looking and added to incrementally over time. Consequently, internal documents might be a poor guide to the competitive importance of new or growing rivals, and over index on larger rivals.

3.9 In addition, firms' business plans and valuations often suffer from optimism bias. For example, a high proportion of merger related business plans that we see assume rising revenues (including successful product launches), falling unit costs and thus growing profits over time. The commercial reality may be very different, not least as rivals or customer pressure might require a firm to cut prices or incur greater costs. This may mean that deal valuations are not

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29 Paragraph 2.28(d) of the Revised Guidelines.

30 That is not to say that the answer is to generally extend the requirement for document production to third parties in a merger, but in assessing the weight to give to internal documents and to the submissions of third parties these potential biases should be considered.

always a good guide to future competitive conditions. Indeed, even outside the context of mergers, the CMA will note that certain companies may have market valuations that are very high relative to their earnings, and it is widely accepted that there may be speculative bubbles in firms' valuations.

3.10 It is clearly right that the CMA may take account of specific post-merger intentions that would be consistent with an SLC, such as increasing prices, less innovation, foreclosure of rivals or entry/expansion.[31] However, these documents still need to be tested for context and realism – i.e. are they consistent with the overall body of evidence? Accordingly, we would caution against the CMA *relying primarily* on business strategy and deal rationale, including documents showing that anti-competitive input or customer foreclosure or conglomerate strategies would be implemented.[32]

3.11 In considering the exiting firm counterfactual the CMA emphasises that it will consider contemporaneous internal documents.[33] This is sensible. However, it is important to appreciate that:

(a) firms' suffering financial difficulties often have poor management information systems and controls such that their true financial state may not be highlighted by contemporaneous documents;

(b) the merger itself may reduce the commercial pressure to address these issues, leading to fewer supporting documents or even an absence of documents; and

(c) the management of a failing target may wish to present an optimistic view of a business' prospects in the absence of the merger, rather than necessarily the most realistic assessment, so as not to compromise the sale process and any purchase price agreed.

31 Paragraph 2.25 of the Revised Guidelines.

32 Paragraphs 7.18(a), 7.20(a) and 7.33(a) of the Revised Guidelines.

33 Paragraph 3.28 of the Revised Guidelines.

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