University of East Anglia

CENTRE FOR COMPETITION POLICY

Response to CMA Consultation (CMA 129): Draft revised Merger Assessment Guidelines

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Consultation response from the

Centre for Competition Policy

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This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

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Comments on draft CMA Merger Assessment Guidelines

The Draft Revised Merger Assessment Guidelines (DRMAG) represent a very significant shift in the CMA's approach. Some long-established cornerstones of merger analysis are substantially downgraded (notably, market definition, market shares, concentration, counterfactuals). Some important new issues are helpfully incorporated or further developed (notably, two-sided markets…). Some issues are left underdeveloped (notably, environmental and distributional issues). Simmering underneath is an apparent shift towards a more regulatory approach, and one with less reliance on economic evidence. We develop some of these issues in the following submission. However, the changes are too numerous and our time constraints have been too tight for us to have been able to cover all the issues raised by the draft (either positively or negatively). We would be happy to discuss the DRMAG further should the CMA wish.

1. Market definition

Market definition has long been the starting point for investigating market power and the assessment of mergers. This is true for most jurisdictions, including by the CMA and its predecessors in the UK. There are good economic reasons for this, including the identification of key competitor firms and the construction of relevant market shares. It is also true that market definition should only be a starting point. It should not be seen as an end in itself, but rather as providing a useful framework for the competitive analysis of the merger. Markets have fuzzy boundaries in both product and geographic dimensions. We also agree that there is no point in duplicating the same analysis in market definition and competitive assessment (which has afflicted some published merger decisions by the European Commission in the past). This much is well understood but it should not be mistaken for justification to dismiss market definition as a starting point.

It is particularly worrying to read in #9.3 that: "measures of concentration can often be interpreted without concluding on a bright-line market definition. For example, the CMA may calculate concentration measures on multiple different bases, including and excluding different firms, depending on which firms the CMA wishes to compare." ***This reads as a dangerous carte blanche for the CMA to define markets on any basis that suits whatever answer it wants to find***.

Furthermore, there is a new concern. The CMA now has jurisdiction over large international mergers that were previously reserved for the European Commission. Running up to this new responsibility, the CMA has already been increasingly assertive in its geographic jurisdiction (e.g. Sabre/Farelogix). This combination brings a potentially very large increase in the range and complexity of international mergers that it may choose to review. The CMA will need a filter for highlighting the most relevant cases to investigate for anticompetitive effects.

Suppose there are ten European suppliers of a relatively standard product (or bespoke product made using a standard technology), who compete actively in the European market. Three of these currently supply to UK, but all ten are equally able to supply. A merger of two of the current suppliers to the UK would appear as a 3-to-2 merger and would result in a combined share of supply of 67%. However, this is only 20% of the European market in which effective competition operates. ***Of course, further investigation would reveal the wider set of effective competitors, but this is exactly what market definition achieves. This could become important for deciding which mergers the CMA needs to investigate independently of the European Commission***.[1]

[1] See Fletcher A and Lyons B, '*Geographic Market Definition in European Commission Merger Control*' (Report for DG COMP), January 2016 http://ec.europa.eu/competition/publications/reports/study_gmd.pdf

2. Indicators of market power: market shares, concentration, and upward pricing pressure

Following on from the downgrading of market definition, concentration is mentioned only five times in the Draft MAGs, and no specific measures are mentioned. ***Three of the five mentions are in a paragraph trying to defend concentration measurement in the absence of market definition***. #9.3 includes the unsubstantiated statement that "measures of concentration can often be interpreted without concluding on a bright-line market definition", which actually makes concentration very much harder to interpret. The other two mentions are: in relation to evidence of market power in *differentiated* product markets, "the impact of past changes in concentration on prices" is at the end of a list of potential "evidence of pre-existing market power" (#4.11a); and the "concentration of *rivals*" is listed in relation to factors that "may make horizontal unilateral effects more or less likely in the context of an *undifferentiated* market" (#4.37, emphasis added).

Yet 'concentration' is mentioned 202 times in the 89 pages of the CMA's recently-published State of Competition Report, and it takes up a third of the analysis in that report. There are additional mentions of specific measures (HHI, concentration ratio). The State of Competition Review is careful to stress the drawbacks of concentration as measure of market power, and ***we agree strongly with those limitations, but it is extreme to sweep the concept away rather than explain that it needs to be interpreted very carefully and in appropriate context***.

Market shares are similarly downgraded in the Draft MAGs. We doubt that the CMA will, in its deliberations, eschew the framing of a merger in terms of market shares, particularly for largely undifferentiated markets. We believe it is better to be open in explaining that this is only a starting point and why it may be misleading in a particular merger context. Nevertheless, nearly all mentions of 'market power' in the draft MAGs imply key evidence in the form of market shares. In particular:

- #4.11(a) on unilateral effects in differentiated markets: "Evidence relevant to market power may include the level and stability of market shares; the number and strength of competitive constraints; the extent of past entry or exit; or the impact of past changes in concentration on prices." Three out of four of these require market definition even in the context of differentiated products (to measure market shares, entry/exit, and concentration).
- In the context of vertical and conglomerate mergers, "The starting point for this assessment [of market power] will be the structure of the upstream market." [#7.13(a)]. Similarly, #7.20 refers to "pre-existing market power in the downstream market". Also #7.32(a) on "Market power in an adjacent market. …This assessment will typically begin with a consideration of the structure of the adjacent market".

The main economic justification for downgrading market definition and market share is where products are differentiated, with some products being closer substitutes than others. In such markets, diversion ratios are standardly used to distinguish closer from more distant competitors. The consequences for upward pricing pressure can be inferred by combining diversion ratios with margin data. This is implicitly acknowledged in #4.11-12 and #9.3, but the only reference to 'pricing pressure' is buried in footnote 77. This is surprising given that one standard measure of pricing pressure, GUPPI, is mentioned 578 times in the CMA's recent Sainsbury/Asda decision, plus an additional 135 mentions in the Appendices!

It is difficult to avoid the conclusion that the CMA proposes to downgrade the hitherto standard quantifications that have long provided a frame for interpreting the qualitative evidence that is also important for understanding competitive effects. We think this would be unwise.

3. Coordinated effects

The CMA appears to be giving mixed messages on coordinated effects. The section starts with an explanation of explicit coordination (cartels) [#6.2].[2] The next paragraph distinguishes tacit from explicit coordination and says "Both can be germane to an assessment of the effects of a merger although explicit coordination is caught by Chapter 1 of the Competition Act 1998 and may be subject to sanction regardless of whether a merger takes place" [#6.3]. This seems to imply that the CMA may find an SLC on the basis of an expectation that the merged firm would make an illegal activity/cartel more likely. ***This would be an extraordinary step***.

This does not mean that the CMA should ignore *past* cartel behaviour – there is an increased incidence of ***mergers in industries following cartel breakdown***, and this ***should be interpreted be a warning sign of mergers that may have the effect of restoring coordinated behaviour***.[3]

Footnote 102 refers to Baker and Farrell, who distinguish tacit collusion based on punishment strategies (as in the Airtours conditions), from recognised interdependence which may even be unconscious (an idea that can be traced back to Chamberlin nearly a century ago). However, the Draft MAG text does not pick up on this distinction, so it is very unclear what the CMA is saying. ***Are the Airtours conditions still the essential framework for merger analysis of coordinated effects (as implied by #6.10), or is the CMA prepared to move away from European precedent to examine alternative (non-game theoretic) forms of coordinated effects?***

4. Potential competition

Section 5 on Potential Competition seems to offer the CMA much enhanced discretion, presumably with one eye on concerns about giant digital platforms but in guidelines that apply to all mergers. The standard counterfactual is the current market structure and the task of the CMA is to appraise the impact of the (currently hypothetical) post-merger market structure. Analysis of 'loss of future competition' requires a comparison of two currently hypothetical market structures (#5.14). Given the overall tone of the DRMAG, with a new stress that uncertain scenarios supported by little evidence should be given similar weight to those backed by strong evidence, the CMA appears to be giving itself considerable discretion. For example:

> *#5.23 "The elimination of an entrant as a potential competitor may lead to an SLC even where entry by that entrant is unlikely and may ultimately be unsuccessful, because the removal of the threat of entry may lead to a significant reduction in innovation or efforts by other firms to protect their future profits."*

This opens an implausibly wide net wide, for example, to include an unlikely potential competitor who nonetheless somehow is presumed to keep third parties worried enough to have a substantial effect on competitive effort.

5. Digital mergers

The CMA Digital Task Force has recently published its advice to Government on the design of 'A new pro-competition regime for digital markets' ('the Advice'). The Advice *inter alia* proposes the creation of a specific merger regime for acquisitions by platforms with strategic market status (SMS).

[2] #6.5 inter alia persists in referring to firms "coordinating" (see also # 6.13).

[3] See Davies, S., Ormosi, P.L. and Graffenberger, M., 2015. Mergers after cartels: How markets react to cartel breakdown. *The Journal of Law and Economics*, *58*(3), pp.561-583.

So far, the Advice and the DRMAG leave the question about the role of the Merger Assessment Guidelines for the review of SMS acquisitions unaddressed.[4]

The Advice envisages that the CMA will review SMS mergers on the basis of the SLC test, while using a lower and more cautious 'realistic prospect' (instead of 'balance of probabilities') standard of proof in phase 2 of its assessment.[5] The Advice also states that the CMA's review of SMS acquisitions will rely on the same economic principles and theories of harm that underpin 'conventional' merger assessment.[6] The Advice further asserts that the lowering of the standard of proof for SMS mergers will not go at the expense of the 'rigour' of the phase 2 process.[7] All this seems to imply that the Merger Assessment Guidelines will also guide the review of SMS mergers. The role of the Guidelines in the assessment of SMS mergers, nonetheless, warrants further clarification. This is not least because the Advice also opaquely refers to further 'Guidance' that is supposed to clarify the degree of in-depth analysis the CMA is expected to carry out in phase 2 of its assessment of SMS mergers.[8]

Further clarification is needed on which sections and analytical filters[9] of the DRMAG will be of (greater) relevance for the analysis of SMS acquisitions. It remains, in particular, unclear how the use of the 'realistic prospect' instead of the 'balance of probabilities' standard in phase 2 of the assessment of SMS mergers will affect the CMA's counterfactual analysis (see for the interplay between the standard of proof and counterfactual analysis #3.12 and 3.13 of DRMAG).

This clarification would also be important as the DRMAG appear to already credit, at least in part, the concern about false negatives that underpins the recommendation to lower the standard of proof for the specific SMS regime. Indeed, the Guidelines clarify that uncertainty about the future development of markets would not be sufficient to prevent the CMA from finding an SLC with respect to potential or dynamic competition (#2.10, 3.10, 5.15, 5.20).[10] The Guidelines also suggest that the CMA will have a certain amount of flexibility when choosing the relevant timeframe for the counterfactual analysis in digital markets (#3.14). One might wonder whether the lowering of the standard of proof recommended in the Advice will allow the CMA to rely on even bolder counterfactuals in the phase 2 assessment of SMS mergers. Conversely, it is also unclear how the CMA intends to prevent that the lowering of the standard of proof for SMS mergers entails a stricter approach to counterfactuals and thus a less effective enforcement with respect to 'conventional

[4] The main document refers to the Draft Merger Guidelines only once with respect to the definition of firms with SMS Competition and Markets Authority (n 1) 4,14 and fn, 39. The text of Annex F (excluding footnotes) refers to the revised Guidelines three times, mainly with respect to the proposed change in the standard of proof for SMS acquisitions.
[5] ibid points 4.149 - 4,153 and Annex F points 89-123.
[6] ibid point 4.150 and Annex F point 123.
[7] ibid point 4.154 and Annex F point 124.
[8] ibid point 4.154 and Annex F point 127.
[9] E.g., non-price parameters of competition (2.4 and 2.5,); two-sided platforms and network effects (4.20-4.25); potential competition (section 5); and counterfactual analysis (section 3)?
[10] Frank Knight's seminal dichotomy between uncertainty and risk draws a strict distinction between risk as 'measurable uncertainty' that can be captured by assigning probabilities to specific events or outcomes and (non-measurable) uncertainty to which no probabilistic value can be attributed F. Knight, *Risk, Uncertainty and Profit* (The Riverside Press Cambridge 1921) 20. Uncertainty (in the strict, Knightian sense) about the future development of markets would prevent the CMA from assigning probabilities to various multiple scenarios and to pick, in keeping with the balance of probabilities standard, the most likely one. The reference to 'uncertainty' in the Guidelines thus suggests that the CMA's phase 2 analysis will also assess the competitive impact of 'conventional' mergers based on the 'realistic prospect' rather than the 'balance of probabilities' standard if the future development of markets is shrouded in uncertainty.

mergers' that continue to be reviewed under the balance of probabilities standard.[11] Further clarification may help to avoid such unintended 'waterbed effects'.

The Revised Merger Assessment Guidelines should clearly articulate the interplay between the assessment of 'conventional' and SMS mergers and the role of the Guidelines for the review of both types of mergers. A decision to postpone the publication of the Revised Merger Assessment Guidelines until the SMS regime for mergers is fully in place would allow the CMA to ensure the coherence between the assessment of 'conventional' and SMS mergers and to guarantee the unity of the CMA's system of merger control.

Finally, App. F #124 of the Advice tries to explain how phase 1 and phase 2 investigations would be different if a merger was being appraised under the 'realistic prospect' standard in each phase. It claims: "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"; that phase 2 would be "a longer and more intensive process"; and that merging parties would have "additional opportunities to make their case… to the decision makers". However, the bottom line is that it would mean phase 2 decision makers would have to reverse the phase 1 decision on the same standard of proof. This might be feasible if Inquiry Groups were as independent as they were at the Competition Commission, but they are not (e.g. compromised role of panel chair).[12] ***It would be very difficult for phase 2 to reach a different decision to phase 1 (i.e. not to find an SLC), so there would inevitably be legal challenges.***

6. Environmental sustainability, equity and vulnerable consumers

There is no mention of the distribution of harm or benefits across the population. Section 4 on unilateral effects discusses differential impact across local areas, but it does not say how the CMA might balance such effects. For example, what is the guidance for the CMA if it expects the merger to result in a greater ability to price discriminate, resulting in no change in average prices but higher prices in wealthy areas and lower prices in areas of poverty? Distributional issues might be incorporated within a standard welfare economics analysis (e.g. income weights), or would the CMA focus exclusively on the harm to consumers in wealthy areas? ***While the CMA should not see its task as promoting equity at the expense of competition, it should have guidance on weighing distributional issues in the (probably rare) mergers that raise such concerns***.

We note that vulnerable consumers get no mention despite being first on the CMA's list of strategic priorities and the primary focus of its consumer protection work. However, we agree that merger control is not the best policy tool to address this.

In contrast, environmental issues are introduced in two places. First, "the sustainability of a product or service" is mentioned as a possible non-price aspect of competition in #2.5. This is relevant if sustainability is valued by consumers and firms actively compete on this dimension. Second, "environmental sustainability and supporting the transition to a low carbon economy" is raised as a potential "customer benefit" in #8.3 and #8.18. Presumably, this is relevant when sustainability is not actively valued by consumers or is not visible to them. The CMA has traditionally been reluctant to give much weight to customer benefits as a redeeming factor (other than in NHS hospital mergers), so the main new effect appears to be where the merger affects the incentive to compete for consumers who value 'green' products. On balance, we agree with this approach, but ***we suggest that the CMA should not lightly dismiss consumer benefits and should be active and willing to***

[11] Competition and Markets Authority (n 1) Annex F points 130-131.
[12] See Lyons (2021) Unfinished Reform of the Institutions Enforcing Competition Law.

make appropriate recommendations for tighter environmental regulation if this is the best way to achieve the environmental objectives claimed by the merger parties.[13]

[13] See Schinkel and Treuren (2020) 'Green Antitrust: Friendly Fire in the Fight against Climate Change'