# RESPONSE OF CLIFFORD CHANCE LLP TO THE CMA CONSULTATION ON UPDATES TO ITS MERGER ASSESSMENT GUIDELINES

Clifford Chance LLP welcomes the opportunity to respond to the consultation on the draft revised merger assessment guidelines by the Competition and Markets Authority (**CMA**) under the Enterprise Act 2002 (**EA02**). Our comments below are based on the substantial experience of lawyers in our Antitrust Practice of advising on merger control procedures for a diverse range of clients, and across a large number of jurisdictions. However, the comments below do not necessarily represent the views of every Clifford Chance lawyer, nor do they purport to represent the views of our clients.

## 1. OVERVIEW AND SUMMARY

1.1 We welcome the opportunity to respond to the CMA's consultation on the draft revised merger assessment guidelines (**Updated Guidelines**). In particular, we welcome the CMA's proposal to update its merger assessment guidelines to reflect the CMA's practice in recent merger cases.

General observations

1.2 We appreciate the CMA's efforts to articulate its proposed approach with regards to "digital markets", but it is important to recognise the risk that this approach is applied more broadly than intended, given the prevalence of technology across industries. As the CMA notes, it is difficult to define "digital markets" (see footnote 5). The definition adopted by the CMA (i.e., a market "*in which intensive use of digital technology is central to the business models of the firms that operate primarily within them*") appears over-inclusive and already out-dated, given the widespread and growing use of digital technology across industries in the UK. The intensive use of digital technology will, in many markets, be an indicator of competitive dynamism, particularly where there are competing business models in the market, and the CMA should, therefore, proceed with caution in applying its proposed approach.

1.3 We are concerned about the general lack of predictability in the Updated Guidelines, particularly due to the CMA's reliance on its "wide margin of appreciation" in respect of the different elements of the substantive assessment. This is all the more important, given the significant uncertainty which merger parties will face following the end of the Brexit transition period and the ongoing economic disruption caused by the Covid-19 pandemic.

1.4 This lack of predictability is at odds with the strict nature of the UK merger control regime, which has resulted in an increasing number of transactions not being completed as planned by the merger parties. Indeed, around 70% of transactions in Phase 2 in the period January 2019 to September 2020 were prohibited, unwound or abandoned by the parties.[1] This rate more than doubled by comparison to the period from the CMA's launch in 2014 to 2017.

[1] Since the beginning of 2019, there have been six examples of merger parties abandoning deals during Phase 2 (*Experian/Clearscore; Thermo Fisher/Roper; Illumina/PacBio; Prosafe/Floatel; TopCashback/Quidco,*

1.5 We would encourage the CMA to offer more precise guidance where possible, in order to increase certainty for merger parties.

Summary of key points

1.6 In our response below, we have not sought to comment on every proposed change in the Updated Guidelines. Instead, we have structured our response according to the issues that in our view are of most importance. In summary, our views are as follows.

1.6.1 The Updated Guidelines introduce a number of changes which give the CMA ever greater flexibility in its assessment of mergers. While we appreciate that the CMA has a margin of appreciation, it needs to ensure that it adheres to the statutory standards set out in the EA02.

1.6.2 The evidential burden on the CMA remains the same for theories of harm that involve changes in future competitive conditions. The Updated Guidelines stress that the presence of some uncertainty does not prevent the CMA from finding a substantial lessening of competition (**SLC**). However, nor does the presence of some uncertainty absolve the CMA from meeting the applicable legal standard.

1.6.3 We appreciate that dealing with uncertainty is difficult; however, the CMA must treat uncertainty consistently. We are concerned that the CMA proposes to apply inconsistent standards of proof between elements of the merger assessment which are "favourable" and "unfavourable" to merger parties. In particular, the CMA has set an extremely high threshold for its assessment of the counterfactual and entry and expansion by third parties. By contrast, Updated Guidelines appear to express a lower standard of proof on the CMA for finding an SLC in a number of scenarios, including those in which one merger party is considered to be a potential entrant into the market of another merger party.

1.6.4 We are particularly concerned by the proposal that a lack of evidence of efforts or explicit entry or expansion plans will not be sufficient to demonstrate that a merger party would not have entered absent the merger. If adopted, such an approach would effectively shift the burden of proof on the merger parties to demonstrate that they would not have entered the market organically.

1.6.5 Given that the CMA will consider whether the counterfactual situation should include expansion by one of the merger parties, the CMA should also consider the opposite. Even where a merger party is not at the brink of financial failure which will lead to its exit, it may become a less strong competitive force in the future. In particular, the CMA should consider the impact of market-wide events, such as a pandemic and Brexit, as well as party-specific events, in its assessment of the counterfactual.

1.6.6 It is helpful to understand the CMA's proposed approach in respect of two-sided markets in more detail. We note the emphasis on non-price aspects of

*Taboola/Outbrain*). By comparison, there were two prohibitions of anticipated deals (*Sainsbury's/Asda, Sabre/Farelogix*).

competition, which the CMA wishes to interpret widely. However, we urge the CMA to base its assessment on appropriate evidence, on a case-by-case basis, without applying shortcuts or presumptions. This includes evidence as to whether non-price factors are of material importance to consumers in the relevant markets and, in cases involving two sided platforms, whether there really are network effects leading to high barriers to entry and negative effects on competition.

1.6.7 We welcome the approach in relation to the assessment of vertical and conglomerate effects, which provides a uniform framework to assess three main foreclosure theories of harm. However, we have concerns that the CMA places undue importance on the lack of enforcement against anti-competitive effects of some mergers to the detriment of the majority of non-horizontal mergers, which are widely accepted to be benign or pro-competitive.

1.7 We set out more detailed responses on certain specific points below.

## 2. A SUBSTANTIAL LESSENING OF COMPETITION

2.1 As the Updated Guidelines note, the CMA will "*decide whether a loss of competition is substantial under the applicable legal standard*" (paragraph 2.8). We agree that the CMA must continue to satisfy the statutory standard of proof as set out in the EA02. We are therefore concerned that the CMA has proposed very broad discretion in its interpretation of what constitutes an SLC and its assessment of the evidence.

2.1.1 As previously confirmed by the Competition Appeal Tribunal (**CAT**), all mergers should be assessed on a case-by-case basis to the same evidential standard, regardless of the theory of harm being considered (see paragraph 2.10). This means that, while there is no special elevated evidential burden for particular theories of harm, there also cannot be a lower evidential burden for particular theories of harm.

2.1.2 In particular, the evidential burden on the CMA remains the same for theories of harm that involve changes in future competitive conditions or "nascent and digital markets." The CMA cannot amend the standard of proof set by legislation through its guidance. The Updated Guidelines stress that the presence of some uncertainty does not prevent the CMA from finding that the relevant SLC test is met (see paragraphs 2.10, 2.26 and 7.36). However, the presence of uncertainty is a relevant consideration and must therefore be taken into account when assessing whether an SLC is likely to arise, on the balance of probabilities, and cannot absolve the CMA from meeting the applicable legal standard.

2.2 We welcome the explicit acknowledgment in the Updated Guidelines that the CMA must take reasonable steps to acquaint itself with the relevant information to enable it to assess whether the statutory standard of proof for an SLC is met, as set out in the CAT's case law (see paragraph 2.19). We agree that the CMA must have a sufficient basis in light of the totality of the evidence available to it for reaching its decision, as noted by the CAT (see paragraph 2.19). We are therefore concerned about the suggestion in the Updated Guidelines that the CMA may undertake less detailed analysis and not interrogate the available evidence extensively, where the evidence

supporting prima facie competition concerns is stronger (paragraph 2.18). The CMA is required to ensure that it has all the necessary evidence and to assess that evidence before it in making its decision. This obligation has been recently reiterated by the CAT.[2]

2.3 We note that the Updated Guidelines emphasise non-price aspects of competition, which the CMA wishes to interpret widely (see paragraphs 2.4 and 2.5). The assessment of non-price factors needs to be grounded in case-specific evidence of whether the factor in question is valued by consumers and the corresponding degree to which market players compete on the basis of that factor. For instance, the CMA should not take into account levels of privacy (referred to in paragraph 2.5) unless it can establish, based on evidence, that they are a material driver of competition in the market under consideration.

## 3. THE COUNTERFACTUAL

3.1 We welcome the removal of limb 3 of the failing firm test (which considers what would have happened to the sales of the firm in the event of its exit). Our experience indicates that this part of the test was unclear and not used consistently; we therefore agree that it should not form part of the test.

3.2 While it is helpful that the CMA takes account of exiting firms in the counterfactual, there are other alternative counterfactuals which should also be assessed. Given that the CMA will consider whether the counterfactual situation should include expansion by one of the merger parties, the CMA should also consider the opposite scenario. Even where a merger party is not at the brink of financial failure which will lead to its exit, it may become a less strong competitive force in the future. The guidance should state that where the evidence indicates that one of the merger parties will likely be a fundamentally weaker competitor in the future, the CMA will take this into account in its assessment of the counterfactual. The CMA should consider the impact of market-wide events, such as a pandemic and Brexit, as well as party-specific events, in line with the CAT's judgment in *JD Sports/Footasylum*.[3]

## 4. HORIZONTAL UNILATERAL EFFECTS

4.1 The CMA proposes to remove the entirety of the current guidance on countervailing buyer power in the Merger Assessment Guidelines (see section 5.9 of the OFT1254) and replace it with only two paragraphs in the Updated Guidelines (see paragraphs 4.18-4.19), without providing a clear reason for that approach. There is a risk that the Updated Guidelines do not provide clear and sufficient guidance to merger parties in assessing their cases and making appropriate submissions to the CMA during the merger notification process.

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[2] *JD Sports Fashion plc v Competition and Markets Authority* [2020] CAT 24, paragraph 144: "*Even given its wide margin of appreciation, the CMA's decision to seek no further information prevented it from putting itself in a position properly to answer the statutory question, and prevented the CMA from having a sufficient basis for making the assessments and reaching the decisions it did*"; and paragraph 183: "*Whilst it is within the CMA's wide margin of appreciation to decide in which part of its analysis it considers a particular matter, it must nonetheless ensure that it obtains the appropriate evidence to enable it to make that assessment.*"

[3] *JD Sports Fashion plc v Competition and Markets Authority* [2020] CAT 24, paragraph 138.

4.2 The Updated Guidelines recognise the importance of buyer power, where a customer has the ability and incentive to trigger new entry (see paragraph 4.18). However, we are concerned by the approach to other forms of buyer power. In particular, the Updated Guidelines note that most other forms of buyer power that do not result in new entry are unlikely to prevent an SLC (see paragraph 4.19). This fails to consider that customer switching can trigger or sponsor the expansion of competitors, not just new entry. It is not correct to say that "*a customer's buyer power depends on the availability of good alternatives they can switch to*", because the exercise of buyer power can create good alternatives. As a result, the CMA should not discount the constraint imposed by large buyers threatening to switch (including "*buyer power based on a customer's size, sophistication, or ability to switch easily*").

4.3 It is helpful to understand the CMA's proposed approach in respect of two-sided markets in more detail. That said, we would urge the CMA to be careful in its application of the guidelines. For example, the classification of network effects as being more likely to give rise to competition issues is concerning (see paragraph 4.24). Network effects can also be positive – this has clearly been the case, for example, in telecommunications markets. Mergers, including those involving two-sided platforms, should therefore be assessed on a case-by-case basis, without a presumption that network effect lead to high barriers to entry and negative effects on competition.

4.4 With regards to local mergers, we understand that the CMA may employ a filtering approach to avoid having to consider a large number of overlaps between the merger parties (see paragraph 4.31). We appreciate that the CMA's filtering exercise is necessary in order to identify any particular local areas for more detailed assessment. However, the CMA needs to ensure that the filtering (including the "decision rule") is predictable, meaningful and proportionate. Otherwise, there is a significant risk of uncertainty for the merger parties.

4.5 In general, we support the CMA's evidence-based approach and agree that it should have access to all relevant materials to make its assessment. We are nevertheless concerned that, in practice, the CMA may tend to focus excessively on internal documents and request from the merger parties a substantial volume of documents that is not relevant to its assessment. For the efficient conduct of the CMA's cases and to avoid an unnecessary burden on the merger parties, we would encourage the CMA to ensure that its requests for documents are targeted and proportionate.

## 5. POTENTIAL COMPETITION

5.1 Given the forward-looking, prospective nature of a merger assessment, there will inevitably be a degree of uncertainty. The CMA is required to assess the likelihood of an SLC arising based on the relevant statutory test (the "realistic prospect" test at Phase 1 and on the balance of probabilities at Phase 2). We appreciate that dealing with uncertainty is difficult; but the CMA must treat uncertainty consistently and it must apply the relevant statutory test.

5.2 We are concerned that the CMA proposes to apply inconsistent standards of proof between elements of the merger assessment which are "favourable" and "unfavourable" to merger parties. In particular, the CMA has set an extremely high threshold for:

5.2.1 a counterfactual in which one of the merger parties is a weaker competitive force, by requiring the failing firm test to be met; and

5.2.2 countervailing constraints from entry and/or expansion by third parties, where the CMA "*must be satisfied*" that rivals will have both the ability and incentive to enter or expand (paragraph 8.32).

5.3 By contrast, the burden of proof on the CMA for finding an SLC appears to be much lower. Indeed, the Updated Guidelines emphasise numerous times that uncertainty does not preclude the CMA from making a finding. In particular, the presence of some uncertainty or lack of evidence will not prevent the CMA from finding:

5.3.1 an SLC (paragraphs 2.10, 2.26, 2.27);

5.3.2 a counterfactual including entry or expansion a merger firm (paragraph 3.18);

5.3.3 a loss of future competition, even where the impact on competition of the acquisition of a potential entrant is uncertain or where there is a lack of evidence of efforts or explicit entry or expansion plans (paragraphs 2.28(c) and 5.15);

5.3.4 a loss of dynamic competition, even where there is uncertainty about the outcome of a dynamic competitive process or where entry by one of the merger parties is unlikely and may ultimately be unsuccessful (paragraphs 5.20 and 5.23); and

5.3.5 conglomerate effect concerns, particularly in "nascent and digital markets" (paragraph 7.36).

5.4 We are strongly of the view that the same standard of proof should apply to both sets of elements. As noted above, that standard of proof is set by the EA02, and the CMA is required to satisfy it.

5.5 We are particularly concerned by the proposal that a lack of evidence of efforts or explicit entry or expansion plans will not be sufficient to demonstrate that a merger party would not have entered absent the merger (see paragraph 2.28(c)). This effectively shifts the burden of proof on the merger parties to demonstrate that they would not have entered the market organically. Proving a negative is an impossible task. This inappropriate extension of the CMA's powers appears to stem from the CMA's concern about "killer acquisitions"[4] and "reverse killer acquisitions."[5] We would urge the CMA to ensure that it is consistent in its application of the EA02 and meets its statutory obligations throughout its assessment.

## 6. VERTICAL AND CONGLOMERATE EFFECTS

6.1 We welcome the approach of the Updated Guidelines in relation to the assessment of vertical and conglomerate effects, which provides a uniform framework to assess three main foreclosure theories of harm. It is particularly helpful that specific guidance for each of the three main theories of harm has been included, rather than focusing on one

[4] Acquisitions "killing" a potential future threat to the buyer's business.

[5] Acquisitions "killing" a potential future organic expansion by the buyer.

example of partial input foreclosure as provided in the current Merger Assessment Guidelines.

6.2 However, we have concerns that the CMA places undue importance on the lower levels of enforcement against non-horizontal mergers. The Updated Guidelines state that "*a number of commentators continue to warn of the substantial risks of under-enforcement against vertical mergers*" (see paragraph 7.6). As the Updated Guidelines recognise, non-horizontal mergers can "*also result in efficiencies such as reduced prices or better product integration*" (paragraph 7.5). This is also borne out by the CMA's decisional practice.[6]

6.3 We would also emphasise the pro-competitive nature of non-horizontal mergers as proven in economics literature. We believe that the views of selected commentators as to the risks of under-enforcement against vertical mergers – which do not reflect a consensus among economists and academics[7] – should not feature in the Updated Guidelines, which are intended to be unbiased guidance for the CMA's and the merger parties' reference. We therefore encourage the CMA to remove this from the Updated Guidelines.

6.4 While we understand that the CMA has a margin of discretion in assessing evidence of vertical and conglomerate effects in a non-horizontal merger, it is also important for the CMA to provide a sufficient degree of certainty to merger parties for their self-assessments and submissions to the CMA.

6.4.1 As a general comment, we note that despite the CMA having discretion in evaluating evidence at its disposal, the CMA is required to consider all evidence available to it. As noted at paragraph 2.2 above, this has been recently confirmed by the CAT. The CMA is also required to make its decision based on the statutory standard of proof.

6.4.2 Although we welcome the inclusion of wider range of evidence in the assessment of the ability to engage in input foreclosure, including non-price elements (paragraph 7.12), we note that such assessment is inherently qualitative and subject to broad interpretation. This leaves merger parties with a high degree of uncertainty. This is especially the case when the CMA's focus "*will be on understanding if collectively these would allow the merged entity to foreclose its rivals, not on predicting the precise actions it would take.*" We are concerned that the CMA will rely on paragraph 7.12 to assert a possibility of input foreclosure on the basis of all the listed mechanisms, collectively, and that merger parties will then have the burden of proving that each and every mechanism could not, in fact be used to harm rivals. We therefore submit that the guidance should make it clear that, notwithstanding its assessment in the

[6] Of the 11 cases where the prime concern involved vertical links and conglomerate effects theories of harm at Phase 1 between 1 January 2019 and 15 November 2020, only one case was referred to Phase 2. Similarly, of the seven cases which involved vertical links and conglomerate effects theories of harm at Phase 2 in the period 1 April 2014 to 15 November 2020, only one case was ultimately blocked.

[7] See, for example, Vertical Mergers and Entrepreneurial Exit, D. Daniel Sokol, 70 FLA. L. REV. 1357, 1371-73 (2018) and The Fatal Economic Flaws of the Contemporary Campaign Against Vertical Integration, G Manne, K Stout, E Fruits - 68 KANSAS L. REV. 923, 925-26 (2020).

round, the CMA will identify the specific mechanisms that it considers could be used to foreclose rivals, and its reasons for that conclusion.

6.5 In terms of the conglomerate effects theory of harm, the Updated Guidelines acknowledge that the long-term, forward-looking assessment of negative impacts of conglomerate effects is inherently uncertain (paragraph 7.36), but state that this uncertainty will not in itself preclude the CMA from concluding that the SLC test is met on the basis of all the available evidence. We submit that this statement should be amended to expressly acknowledge that uncertainty, and the degree of such uncertainty, are relevant considerations that the CMA will take into account in its assessment of whether an SLC is sufficiently likely to arise.

## 7. COUNTERVAILING FACTORS

7.1 We note that the CMA considers that entry and/or expansion preventing an SLC from arising would be rare (paragraph 8.26). In particular, the CMA appears concerned that on occasion, when it has relied on entry or expansion to clear mergers, that entry or expansion did not in fact materialise. We note that the CMA is placing a very high evidentiary standard for proof of entry and expansion. We would like to remind and emphasise to the CMA that it is entirely consistent with the balance of probabilities standard of proof that some likely events do not, in the event, materialise. The CMA should not consider that it has failed to "catch a merger" just because there were instances where it considered potential third party entry or expansion which then did not actually take place. The same is true of SLC findings based on harm that did not materialise: it is possible – and, over numerous cases, statistically probable - that the harm identified by the CMA in certain mergers (which were addressed by remedies or blocked) would not have occurred, even if it was likely.

7.2 The Updated Guidelines rely on a report carried out by KPMG which was commissioned by the CMA in 2017, to support the argument that in some instances where the CMA relied on entry or expansion to clear mergers, such entry and expansion eventually did not materialise (see paragraph 8.26).[8] It is worth noting that this report was based on evidence from only eight merger cases in the period 2009 to 2015, selected from a list of cases recommended by the CMA,[9] and therefore suffers from selection bias.[10] The report itself also admits the limitations of its methodology, which underestimates the likelihood of unexpected entries in the market.[11] We are concerned that a limited study with flawed methodology and selection bias (leading to an unreliable conclusion) is not a suitable basis for demanding a high evidentiary standard for proof of entry and expansion, and will therefore result in over-enforcement.

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8 KPMG, Entry and expansion in UK merger cases: an ex-post evaluation, April 2017.

9 KPMG, Entry and expansion in UK merger cases: an ex-post evaluation, April 2017, paragraph 4, page 5.

10 To put this into context, there were nearly 500 merger cases with decisions reached in Phase 1 alone in the same period.

11 KPMG, Entry and expansion in UK merger cases: an ex-post evaluation, April 2017, paragraph 3, page 5: "*We recognise, however, that focussing on clearance decisions limits our ability to test whether the Authorities may have over-enforced or under predicted entry or expansion. Selecting these clearance decisions also means we are focussing on cases of expected or failed entry, and may be less likely to observe entry that was unexpected.*"

## 8. THE MARKET IN WHICH AN SLC ARISES

8.1 The Updated Guidelines provide the CMA with an excessively high degree of discretion in determining what constitutes the relevant market, as summarised below (see paragraphs 9.3-9.5).

8.1.1 The CMA may calculate concentration measures on multiple different bases, including and excluding different firms, depending on which firms the CMA wishes to compare.

8.1.2 The CMA may define the relevant market by describing the most important constraints on the merger firms.

8.1.3 There is no requirement for the CMA to come to finely balanced judgements on what is "inside" or "outside" the market. However, the CMA nevertheless proposes to assess the closeness of competition between two firms "inside" the market and the constraint posed by firms "outside" the market. It is unclear how the CMA proposes to do so without actually coming to a view on the definition of "the market" itself.

8.2 The Updated Guidelines, as currently drafted, give rise to a lack of certainty for the merger parties in carrying out their assessment, and therefore would significantly affect the merger parties' ability to present their cases to the CMA.

8.3 Finally, we also note that unlike the current Merger Assessment Guidelines which provide that the CMA will usually reach a conclusion on the boundaries of the relevant market in Phase 2,[12] there is no such requirement in the Updated Guidelines. In other words, the CMA does not expect to reach a conclusion in relation to market definition even in Phase 2 investigations. This seems surprising, given that the CMA carries out a lengthy, in-depth assessment at Phase 2. We would expect the CMA to be able to form a view of the market and issues in question, having obtained a significant volume of information from all parties and spent a long time to consider the cases put forward to it. The CMA's decisions have important precedential value to merger parties and their advisers for assessing their cases, and conclusions on market definition contribute to the predictability of the UK merger control regime.

We hope that the comments set out above will be helpful to the CMA in further formulating its approach to the substantive aspects of merger reviews. In case of any questions, please let us know.

**CLIFFORD CHANCE LLP**
**8 January 2021**

[12] OFT1254, paragraph 5.2.4.