Draft CMA Merger Assessment Guidelines Consultation

CMS comments

1. INTRODUCTION

1.1 An update of the CMA's merger assessment guidelines in order to reflect the new and evolving economic landscape in which mergers now take place is to be encouraged and welcomed by stakeholders and practitioners.

1.2 CMS Cameron McKenna Nabarro Olswang LLP ("**CMS**") has taken this opportunity to respond to the CMA's consultation concerning its draft Merger Assessment Guidelines (the "**Draft Guidelines**"). We have not commented on all of the proposed changes; instead we have focused our comments on what we have identified as the key issues. In addition to our overarching observations below, we have included comments in relation to more specific areas of draft guidelines in the Annex.

2. TREATMENT OF UNCERTAINTY

2.1 It is striking that the terms "uncertain" and "uncertainty" do not feature at all in the 2010 Guidelines and yet in the Draft Guidelines these terms feature on 17 occasions. We recognise that this emphasis on uncertainty reflects the CMA's increasing focus on conducting 'forward-looking' competition assessments (for example, by adopting a future counterfactual or when assessing the loss of potential competition).

2.2 The CMA notes at, para 2.26, "*the presence of some uncertainty will not in itself preclude the CMA from concluding that the SLC test is met*". On its face, this is a reasonable position to adopt. For example, the merest degree of uncertainty should not, itself, preclude the CMA establishing a realistic prospect of a substantial lessening of competition (SLC). That is largely the position that the CMA adopts presently, even where its counterfactual is based on pre-existing conditions of competition.

2.3 However, the CMA's intention in other parts of the Draft Guidelines is less clear. For example, at para 2.10, the CMA notes: "*The fact that there may be some uncertainty in how the market is likely to develop in future does not, by itself, reduce the likelihood that a merger could give rise to competition concerns…".* Similarly, at para 3.14: "*Uncertainty about the future will not in itself lead the CMA to assume the pre-merger situation to be the appropriate counterfactual*".

2.4 The CMA does not elaborate on what it means by "some" uncertainty in this context. Nor do the Draft Guidelines convey how the CMA will react in the face of a high degree of uncertainty (other than implicitly, by reference to the reference/prohibition threshold). As noted above, the existence of uncertainty should not, itself, preclude an adverse finding. However, the degree of uncertainty concerning a future scenario should, itself, affect the CMA's level of confidence in predicting it will come to pass. That is, the higher the level of uncertainty, the less confident the CMA ought to be. This (hopefully) uncontroversial rule of thumb is not expressly reflected in the CMA's handling of uncertainty.

2.5 While we recognise that the UK merger regime has come under scrutiny in relation to whether small numbers of previous mergers (most notably in the digital sector) were incorrectly cleared, in our view. the CMA should not be faulted for failing to see all ends and accurately 'predict the

future'. That is not a realistic (or even desirable) ambition for any sophisticated competition authority, particularly when operating in highly dynamic markets.

2.6 To that end, we consider the suggestion at para 3.43 of the DCEP[1] report - that the fact that there have not been any false positives to date (i.e. mergers that were prohibited but should have been cleared) while there are likely to have been some false negatives (i.e. mergers which were cleared but should have been prohibited) is indicative of underenforcement - to be an unhelpful characterisation. The report's reflection that "*mergers can look very different with the benefit of hindsight*") is the more pertinent observation, in our view. The question is whether the merger is likely to lead to an SLC based on the information available at the time.

2.7 Moreover, while the Lear report called for authorities to accept "more uncertainty" in their decision-making, this is not to be equated with accepting any and all degrees of uncertainty. Indeed, as the DCEP report recommended, the preferred approach is for the CMA to develop its own coherent **framework** for resolving such uncertainty in its balancing of the evidence:

> "*Being alert to the threat of killer acquisitions does not mean assuming all purchases of small firms by big firms pose a special threat, even in digital markets. The point is that the CMA should develop and use a clearer framework for looking beyond current market conditions to examine how the transaction might affect future innovation and consumer welfare*." [2]

2.8 In summary, where there is a high degree of uncertainty affecting the grounds for prohibiting a merger, the default position ought to be to clear (or, if at phase I, not refer,) the transaction. The suggestion that the CMA should, on the basis of highly uncertain or speculative evidence, take an adverse decision anyway (to test its legal boundaries or otherwise) risks creating a slippery slope towards a damaging and investment-chilling climate for businesses. We assume this was not the CMA's intention, but would welcome clarification.

2.9 As discussed below, the CMA appears to adopt a more rigorous approach when dealing with the issue of uncertainty in another context in the Draft Guidelines: the prospect of potential merger-induced entry by *third parties* into the relevant market (e.g. at paras 8.31 – 8.33). There, the CMA correctly observes that its predictions about future competitor entry have, in some instances, failed to materialise (para 8.26). As such, the CMA implies the need to discount the evidential weight attached to future competitor entry, in order to take into account the level of *uncertainty* associated with such entry. This note of caution about failed predictions in the face of uncertainty should serve as a cautionary tale when similarly attempting to forecast the merger parties' *own* entry plans.

3. LOSS OF FUTURE COMPETITION

3.1 The Draft Guidelines note that an assessment of the loss of future competition between the merger parties must be based on whether one of the parties "*would*" enter the affected market (para 5.7). This is the correct threshold that the case evidence must support, i.e. the evidence should not merely demonstrate that a merger party "might" theoretically enter the market.

3.2 However, at para 5.10, the CMA also appears to suggest it may infer that such entry would occur by reference to, for example, previous M&A activity in related markets.

3.3 The technical ability to enter a market (even if such an opportunity might prove profitable) is not a sufficient basis to conclude that a firm "*would*" enter. Businesses may theoretically be able (and

[1] Unlocking digital competition, Report of the Digital Competition Expert Panel.

[2] Para 3.54. DCEP report..

even incentivised) to enter a great number of markets, but ultimately not do so for any number of commercial or strategic reasons. It appears tenuous to infer that a merger party "would" do something in the complete absence of any actual evidence suggesting that it had explored or even contemplated such entry. We would expect the CMA to establish that such plans had been explored or were being explored by the relevant merger party, rather than impute such entry in the merger parties' strategy plans.

3.4 In addition, the Draft Guidelines are notably silent on key issues that would affect the ability and likelihood of one of the merger parties to successfully enter a relevant market. For example, the following factors are not referred to in the section dealing with potential competition as between the merger parties (but are all referred to in the part of the Draft Guidelines relating to the prospect of third party entry):

3.4.1 Whether the merger party has detailed plans to enter: For instance, in the section dealing with third party entry, the CMA notes it "*is likely to place greater weight on detailed consideration of entry or expansion and previous experience of entry and expansion (including how frequent and recent it has been*)" (para 8.27).

3.4.2 Whether entry would be sufficiently timely. For example, when dealing with *third party* entry, the CMA notes "*generally, the further out in time that entry or expansion is expected to occur the less certainty the CMA can attach to it*" (para 8.31).

3.4.3 Whether market conditions, such as a declining market size, may affect the prospect of entry by one of the merger parties (para 8.32).

3.4.4 Whether barriers to entry would pose challenges to one of the merger parties ability to successfully enter and make an impact in the market (8.37).

3.5 We recognise that the CMA will wish to adopt a cautious view, particularly in a phase I assessment. However, the above factors are all sensible considerations that the CMA should factor into its analysis of potential competition, too. Moreover, given that the CMA will take into account entry or expansion by potential rivals over a similar time horizon, as a matter of procedural fairness, there ought to be a degree of even-handedness as to the treatment of evidence as between the prospect of entry by, on the one hand, one of the merger parties, and on the other hand, a third party entrant.

4. COUNTERFACTUAL

4.1 The Draft Guidelines indicate that the CMA will be more prepared (even in phase I assessments) to adopt a future-based counterfactual rather than comparing the transaction against the pre-merger conditions.

4.2 A two-step approach is laid out: (i) establish which counterfactual is most realistic, and (ii) where there are multiple realistic counterfactuals, the most competitive counterfactual is selected in a phase I review.

4.3 The CMA notes that it will focus on the most "significant changes" affecting competition between the merger firms. However, the CMA only refers to future scenarios in which the merger firms may, in the future, undertake changes which enhance the extent of competition between them.

4.4 There may be circumstances in which one of the merger firms is experiencing a negative spiral (e.g. persistent and declining subscriber numbers), which is forecast to continue. In these circumstances, which are not altogether rare in the context of a business sale, the most "realistic" counterfactual may indeed be *weaker* competition than before (but not quite market exit). We

would welcome clarification from the CMA about how its counterfactual assessment will take into account this sort of scenario.

5. ONLINE VS PHYSICAL CHANNELS

5.1 Given the tension between online and physical markets, the Draft Guidelines represent an opportunity for the CMA to establish some of the factors it is likely to take into account when considering whether a physical sales channel is constrained by an online sales channel (and vice versa). The Draft Guidelines could, for example, take stock of historical decisional practice on how the CMA has examined the degree of competition as between these two channels for the supply of goods and services, and an indication of how such an assessment is likely to be framed in a phase I and phase II assessment (particularly in light of the CMA's relaxation of strict market definition boundaries).

6. FIRST MOVER 'PENALTY'

6.1 Given the CMA's tendency to characterise online markets as a distinct frame of reference/market from other distribution channels, entrepreneurial start-ups that have set up 'disruptive' online models (particularly where the 'disrupted market' is a traditional bricks-and-mortar market) can find their 'new' service is characterised by the CMA as a 'market' itself. This can give rise to a number of unfortunate consequences for the first mover:

6.1.1 They are more likely to be found to have a "high" and potentially even monopolistic market share. Ironically, this may even be the case where the 'disrupted market' is occupied by large incumbents with substantial market power themselves.

6.1.2 In disruptive business models, a "competitor" may not actually exist at a nascent stage of market development. Indeed, the only constraint may be that such services are traditionally carried out on an in-house basis by customers. However, self-supply is rarely considered a meaningful competitive force in merger assessments, even in newly developing markets.

6.1.3 Start-up business models and financing structures are often formulated around the prospect of an investor exit / business sale within a certain time-horizon. While a sale to a direct and close competitor ought to draw scrutiny from the CMA, our concern with the CMA's broad approach to assessing any "loss of future competition" means that acquirers active in related or complementary markets may face an expensive and gruelling investigation covering the loss of "potential" competition that might have hypothetically occurred had the acquirer independently entered such market (even though no actual plans to enter existed, as per our comments in section 3 above). Moreover, this would disproportionately affect successful first-movers (as the CMA notes that "*the impact of a potential entrant on competition is more likely to be significant when there are few strong existing competitive constraints on the other merger firm*" (para 5.15)).

6.2 While we recognise that the CMA is attempting to guard against perceived underenforcement in the past, an overly aggressive and speculative approach to merger assessments risks having longer-term market chilling effects. We would welcome a short-section in the Draft Guidelines clarifying how the CMA will view competitive constraints in the case of newly emerging or nascent digital 'markets', particularly in the light of the CMA's intention to relax aspects of its approach to market definition (which would allow for a broader range of constraints to be taken into account).

7. ASYMMETRIC COMPETITION

7.1 Practitioners can find themselves advising on merger transactions where a large market operator is acquiring a very small operator. In such cases, the evidence may point to the existence of an asymmetric constraint as between the merger parties (e.g. only the larger firm constrains the small operator). There is disappointingly little content in the Draft Guidelines to guide merger parties on (i) how the existence of asymmetric competition affects the CMA's analysis of the counterfactual, the loss of competition and barriers to entry, and (ii) the sort of evidence the merger parties should focus on providing to the CMA during pre-notification in such circumstances in order to conduct the case as efficiently as possible.

CMS[3]
11 January 2021

[3] These comments were co-authored by Brian Sher, Kabir Garyali, Jonathan Carter-Lewis, Shona Murphy and Lucy Charatan.

Annex

Draft CMA Merger Assessment Guidelines - CMS comments

These comments complement our broader comments in the main part of this submission.

Section	Para reference	Comments
What is an SLC?	2.5	The CMA refers to non-price aspects of competition, such as the level of privacy offered to consumers or whether adverts are served. The CMA ought to avoid making any value judgments about whether adverts are inherently a 'good' or 'bad' thing (i.e. no adverts vs adverts being akin to low prices and high prices). Rather, the important aspect is whether a *choice* is offered to consumers by a given platform, as the degree of choice (equivalent to 'range') is the key parameter of competition.
What is an SLC?	2.17(a)	The CMA notes, as an example, that a merger resulting in the number of suppliers going from 4 to 3 (and involving the market leader) can result in an SLC finding. Given that a 5 to 4 threshold is often adopted by the CMA to eliminate any prospect of competition concerns, presenting a 4 to 3 merger (involving the market leader) as the very basis for an SLC finding gives rise to a harsh dividing line between the two thresholds. For that reason, we assume that the CMA would take into account other factors (such as the size of the remaining suppliers, e.g. the second and third largest firms in the market) when determining if a 4 to 3 merger involving the market leader satisfied the SLC threshold. For clarity, we suggest that the CMA includes, at the end of footnote 30, wording to the following effect: "*Similarly, nor does it mean that an SLC will necessarily be established in such a scenario, as other circumstances relating to the merger will be relevant*."

Counterfactual	3.21 and 4.15	At 3.21, the CMA notes that third party entry/expansion that may occur (with or without the merger) is not usually considered in the CMA's counterfactual, and that such evidence is explored as part of the competitive assessment. However, at 4.15 (the section dealing with the competitive assessment), the CMA notes that entry by rivals that would have occurred irrespective of merger "*would form part of the counterfactual*". This contradicts the position noted in 3.21 and requires clarification.
Potential Competition	5.3, 5.4, 5.17	The CMA has added a new element to its section on potential competition, namely the competitive effects of the "loss of dynamic competition". The CMA's assessment of the competitive effects from the loss of future competition requires a review of (1) the prospect of entry and (2) the impact of potential entry of a merger firm. The loss of "dynamic competition" is less well defined and far broader in its application. The guidance states that there can be uncertainty as to whether products or services will ever ultimately be made available to customers. Moreover, there need not be any specific future overlaps at the time of the assessment but a "*broader pattern of dynamic competition*". While we understand the theoretical concern, we would welcome further clarification on how such an assessment will practically be carried out. The assessment relating to the loss of innovation is similarly opaque. It seems that the only matter of interest is whether there are efforts or investments being made by the parties in broadly related areas, and that as a result of the merger, the incentives to continue with these efforts/investments will reduce. It would be helpful to have further examples, including examples of when the CMA will consider that there is not a loss of dynamic competition. This would be particularly helpful in the digital/pharmaceutical sector, where most companies will be engaging in dynamic competition in some form.
Merger efficiencies that enhance rivalry – network effects *inter alia*	8.9	The Draft Guidelines largely refer to network effects as a phenomenon that acts contrary to the interests of competition in a given market. However, network effects are, from a consumer standpoint, a positive feature of a platform too. There may be circumstances in which two smaller platform operators merge in order to take on a large incumbent platform. The two smaller platforms would hope to combine their respective user base and leverage the resulting network effects in order to pose a stronger constraint on the incumbent. It would aid practitioners to refer to this as an example of a rivalry-enhancing efficiency in the Draft Guidelines, among other examples of such efficiencies

Market definition – parameter flexing	9.11	The CMA notes that where multiple product markets cannot be aggregated on the basis of demand-side or supply-side considerations, the CMA "*may aggregate them if the main parameters of competition are set uniformly across those markets*." This section is unclear as to its meaning and practical application. For example, if data collection is a key parameter across several distinct online markets, is the CMA suggesting it may aggregate all of these distinct markets (potentially spanning several sectors) into a single "market" where data is collected in a uniform way across them? This section requires further detail in order to assist stakeholders who will come to depend on these guidelines.
Market definition – assessment	9.2	We note that the CMA will be placing less emphasis on the strict market definition and consider, in a broader sense, the degree of competitive constraints acting on the merging firms. We would welcome clarification on the following: - Does this mean that the CMA will place less weight on its market share analysis (which is, by definition, framed around a given market)? - Does this mean that the CMA will be more willing to embrace the extent of competition faced by the merger firms from operators that technically fall outside the strict lines of the market definition, but nonetheless will pose a degree of constraint on the merged business?

CMS
11 January 2021