COMPASS LEXECON

Comments on Draft Revised Merger Assessment Guidelines

Response to consultation CMA129 CON

Neil Dryden,[1] Joe Perkins[2]

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Non-Confidential

1 Introduction

1.1 This note summarises our comments on the CMA's draft revised merger assessment guidelines of November 2020. It is not intended to be comprehensive, but instead identifies some areas where we think the draft guidelines could benefit from further development. The views in this note are those of the authors alone, and do not represent the corporate position of Compass Lexecon or any other organisation.

1.2 We would be pleased to discuss any of our comments further if the CMA would find it helpful to do so.

2 Big picture

2.1 Our view, supported by evidence from the academic literature, policy reviews and the Lear evaluation of recent tech sector mergers, is that overall there is evidence that there has in the past been under-enforcement of merger control in the UK and other major jurisdictions,

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1 Neil Dryden is an Executive Vice President at Compass Lexecon. He has advised on four Phase 2s and several notable Phase 1s in the past three years, including Amazon / Deliveroo, JD Sports / Footasylum, Thermo Fisher / Roper Technologies, Global / Exterion Media, Stonegate / EI, Hunter Douglas / Hillarys.

2 Joe Perkins is a Senior Vice President and Head of Research at Compass Lexecon and an (unpaid) member of the Council of Management of the Regulatory Policy Institute. From 2016 to 2020, he was chief economist at Ofgem, and before then was director of Regulation, Competition and Consumers at the National Audit Office, in which capacity he led the NAO's 2016 report into the UK competition regime.

dating back to 2000 or earlier.[3] Recently, the UK and EC jurisdictions, at least, seem to have become more active, so the position over the last few years is less clear.

2.2 In this light, the revised guidelines' emphasis on the need for a more forward-looking approach to mergers is welcome, particularly in highly uncertain digital markets. However, we have two main concerns with the proposed guidelines:

a. They express a very high, and unwarranted, degree of scepticism about the potential for mergers to enhance efficiency to the benefit of consumers.

b. By providing very substantial scope for discretion in the CMA's approach, they may lead to unpredictable and inconsistent decision-making. Relative to the 2010 OFT / CC guidelines, or the DoJ / FTC merger guidelines, they are vague about how the CMA will conduct analysis in several important areas.

2.3 Taken together, these concerns mean that the overall effect of the proposed guidelines could be to enable a substantial lessening of competition (SLC) to be found in any significant horizontal merger. The effect of paragraphs 2.16 to 2.28 seems to be to say that there are many situations where an SLC could emerge, and that the CMA can use a high degree of judgement in determining whether one exists.

2.4 This move away from a neutral tone is quite marked relative to the existing guidelines, which say, e.g., that *"Many mergers are either pro-competitive or benign in their effect on rivalry"* (4.1.3). The equivalent here is *"Some mergers will lessen competition but not substantially so, because sufficient post-merger competitive constraints will remain to ensure that rivalry continues to discipline the commercial behaviour of the merger firms. However, some mergers lead to a lessening of competition that is substantial"* (2.7). Given historical under-enforcement, a change in tone may be justified, but the proposed revision may embed a presumption against mergers in general.

2.5 Since it is unlikely that, in practice, significantly more mergers would be prohibited than at present, this would leave a high degree of discretion with the particular panels involved, and would also create unnecessary uncertainty in the market for corporate control. It would hence increase the likelihood of errors in decision-making in both directions.

2.6 We would therefore recommend:

a. A more neutral approach to potential efficiencies.

b. A more predictable approach to decision-making, with greater clarity of when different methods will be applied.

2.7 The remainder of this note discusses these two issues in more detail, and then provides miscellaneous comments on some other elements of the guidelines.

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[3] To be precise, some significant mergers were permitted that with hindsight appear to have been anti-competitive in their effects (type II errors). There has been limited analysis of whether there have also been several type I errors (rejecting pro-competitive mergers).

3 Efficiencies

3.1 The consultation document notes that *"the CMA's experience has been that it is rare for countervailing measures … to be the primary reason why a merger is cleared"* (para 1.51). The draft guidelines state that the *"CMA's experience is that it is unusual to find merger-specific efficiencies that would benefit consumers and rare for a merger to be cleared on the basis of efficiencies"* (para 8.6).

3.2 This is true. For instance, of the last eleven closed mergers that reached phase 2 in which merger-specific efficiencies were claimed and explicitly assessed, the CMA accepted that there were any merger-specific efficiencies in only one of them – Asda / Sainsbury.[4]

3.3 However, it is not obvious that the CMA's approach is correct, and there is a circularity in using evidence from current practice to support its continuation. The draft guidelines cite only a general US-focussed article,[5] which is largely reliant in its discussion of efficiencies on a 2004 non-peer reviewed study by McKinsey. They do not cite the CMA-commissioned evaluation of tech sector mergers; the authors found that, in both of the mergers they studied for their academic article, merger-specific efficiencies were plausible.[6]

a. Of Facebook / Instagram, they concluded that Facebook's ability to target advertising more effectively *"may have generated additional benefits to consumers, which may have not arisen in the absence of the merger. These efficiencies seem also to be merger-specific, and it is difficult to assume that they would have arisen in a counterfactual scenario where Instagram was not acquired by Facebook or another social network."*

b. Of Google / Waze, they concluded that *"the merger has enabled Google and Waze to exploit their complementarities and generate efficiencies. These efficiencies are clearly merger-specific and should be taken into account when assessing whether the decision has proved to be beneficial or detrimental to consumers."*

3.4 Such efficiencies go beyond traditional analyses of the impacts of a merger on marginal costs, into complementarities between different products and datasets to the benefit of consumers. However, the proposed revisions include no mention of these effects, and indeed provide much less detail on possible types of merger-related efficiency than the current guidelines.

3.5 There is also a marked asymmetry in the CMA's approach in practice to efficiencies relative to anti-competitive effects.[7] Expected anti-competitive effects are allowed to emerge from economic modelling of the incentives on merging parties, but economic evidence is rarely

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[4] The mergers were: YPO / Findel; Tobii / Smartbox; Taboola / Outbrain; Bauer; Ecolab / Holchem; Prosafe / Floatel; Asda / Sainsbury; Thermo Fisher / Gatan; JLA / Washstation; Experian / ClearScore; and Electro Rent / Microlease. We looked at provisional findings or phase 1 decisions when the merger was cancelled during phase 2.

[5] Kwoka (2018), *Reviving Merger Control: A Comprehensive Plan for Reforming Policy and Practice*.

[6] Argentesi et al (2019), *Merger Policy in Digital Markets: An Ex-Post Assessment*.

[7] In a US context, Crane (2011), *Rethinking Merger Efficiencies* discusses some of the problems caused by an asymmetric approach, concluding that *"[i]t not only stands in the way of some socially desirable mergers but also may indirectly facilitate the clearance of some socially undesirable mergers."*

permitted with regard to efficiencies, which are instead analysed on the basis of pre-merger internal documentation. We are aware of a recent case in which double marginalisation benefits were discounted because they had not been discussed in merging parties' documents before the merger, even though they emerged from the same analytical model as that which the CMA used to identify upward pricing pressure.

3.6 This asymmetry is reinforced in the draft guidelines. When analysis may support the finding of an SLC, the guidelines state that *"[a] lack of evidence of efforts or explicit entry or expansion plans made available to the CMA will not be sufficient to demonstrate that the firm would not have entered absent the merger"* (2.28c). But where documents support the arguments of the merging parties, the guidelines state that *"the CMA may be likely to attach more evidentiary weight to such documents* [supporting the merging parties] *if they were generated prior to the period in which those firms were contemplating or aware of the merger…"* (2.28a). We would recommend explicit recognition that, where the evidence bases for an SLC and for efficiencies are the same, they should be similarly weighed.

3.7 More broadly, the draft guidelines do not mention the now-vast literature on the importance of management practices for productivity. If management practices have a central impact on business effectiveness, a well-functioning market for corporate control is likely to be important to improving them.[8]

3.8 Scepticism about efficiencies is of course warranted. But given the evidence that such efficiencies may be significant, a general presumption against them, as seems to be revealed in CMA decision-making in practice, looks excessive, and potentially damaging to long-term consumer welfare. We would also suggest that it would be valuable for the CMA to carry out or to commission more *ex post* evaluations to assess whether and when efficiencies are likely to be important.

4 Predictability of decision-making

4.1 We recognise that the CMA wishes to take a case-by-case approach, but the pendulum in the draft guidelines has in our view swung too far in the direction of discretion. This is reflected in frequent statements such as that *"merger assessment is inevitably case specific"* (1.12), that *"the appropriate counterfactual will depend on the circumstances of the case"* (3.35) and that *"the appropriate approach* [to market definition] *will reflect the circumstances in each case"* (9.2).

4.2 Taken together, such statements may confuse an entirely appropriate dependence of decisions on the facts of a case with much less justifiable changes in analytical approaches or evidential burdens between cases. It would be helpful if the guidelines were to make clear that the CMA would expect to see a high degree of commonality in its analytical framework across different mergers.

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8 See Bloom and van Reenen (2007), *Measuring and explaining management practices across firms and countries*; Bai et al (2020), *Management Practices and Mergers and Acquisitions*. Padilla and Petit (2020), *Competition Policy and the Covid-19 Opportunity* discuss some of the problems that could result from over-enforcement of merger control.

4.3 While there are often good reasons for a change in approach relative to the 2010 guidelines, the shifts seem always to be in the direction of greater discretion, and sometimes with a concomitant loss of clarity. Clear analytical frameworks, agreed in advance, help to reduce the scope for subjective judgement, enhance transparency and accountability, and provide safe harbour benefits for firms contemplating mergers.

4.4 One particular area where greater clarity and predictability would be beneficial is in the use of upward pricing pressure indices and related rules of thumb to understand the unilateral impacts of a merger. There has been substantial policy and academic debate and development of these methods in the decade since the OFT / CC guidelines were published, but this is not reflected in the draft guidelines, which are instead less detailed on this topic than in 2010.[9]

4.5 CMA practice varies widely, and apparently unsystematically, between cases, with some using GUPPI analysis throughout, others as an initial screen, and others disregarding it entirely, or using an illustrative price rise (IPR) approach instead. The analysis is rarely cross-checked against evidence from competition in the pre-merger market. Clarifying when different methods are likely to be most appropriate would provide substantial benefits in enhancing the predictability and consistency of the CMA's work.

5 Miscellaneous comments

Market definition

5.1 The draft guidelines represent a dramatic change in the prominence given to market definition. For instance, the demand-side discussion of market definition has been reduced from over 1,000 words in 2010 to 67 now. We welcome this change of emphasis, which reflects a developing academic and policy consensus that debates over market definition can cloud rather than clarify the actual processes of rivalry in a market.[10]

5.2 However, we would recommend clarification of the guidelines in three respects:

a. Clarity that, if market definition is to be carried out, the hypothetical monopolist test is the appropriate framework in which to do so. The logic of Bishop and Walker's (2010) textbook on the economics of EC competition law is still relevant:

> *"It cannot be stressed enough that defining relevant markets on a basis that is not consistent with the principles of the Hypothetical Monopolist Test will, almost by definition, fail to take properly into account demand-side and supply-side substitution possibilities. In consequence, any market shares calculated from such market definitions will not provide, except purely by chance, a good proxy of market power."*

b. Clarity on the nature of the test to be applied. Paragraph 9.7 states that:

> *"The relevant product market is identified primarily by considering the response of customers to a small but significant increase in price (or equivalent reduction in the*

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9 E.g., Pakes (2011), *Upward Pricing Pressure Screens in the New Merger Guidelines: Some Pro's and Con's*; Pittman (2017), *Three Economist's Tools for Antitrust Analysis.*

10 See, e.g., Glasner and Sullivan (2020), *The Logic of Market Definition*.

value offered to customers) on the products of the merger firms (demand-side substitution).”

It is not clear whether the failure to include ‘non-transitory’ in the standard SSNIP test formulation is deliberate or not. Nor is it clear whether the test is to be applied to the products of the merger firms alone, or to other products in the same market too (as would be the case in the standard SSNIP test approach).[11]

c. Guidance on when particular approaches to market analysis or definition are likely to be applied. The proposed guidelines cite the CAT’s judgement on *BT v Ofcom* that *”in certain situations it may be possible for an authority to avoid conducting a full relevant market analysis. For example, a decision may not hinge on the precise boundaries of the market in question.”* But this is used as support for a blanket statement that the CMA’s assessment need not be *”based on a highly specific description of any particular market definition”* (9.5). It would be more helpful to understand better the situations where the CMA thinks a full approach to market definition is required and where a more heuristic approach may be justified.

Vertical and conglomerate effects

5.3 The discussion of vertical and conglomerate effects feels old-fashioned, principally based around a straightforward linear relationship between firms. It might be helpful to incorporate explicitly insights from recent work on digital markets, such as recent work on data-driven envelopment strategies.[12]

Relevant consumer benefits

5.4 The draft guidelines’ mention of potential benefits via increased sustainability is welcome. Two other wider impacts that could perhaps also be mentioned are:

a. Monopsony power. This was touched upon in the old guidance, and has become an important issue in merger control in the US in particular, with some discussion in the UK too.[13]

b. Wider impacts on innovation. Prohibiting more mergers could lead to less innovation as firms are reluctant to invest without a clear exit route.[14] Conversely, prohibiting mergers could reduce the extent of a ‘kill zone’ effect, whereby innovation in some areas is reduced because of overlaps with the products of existing dominant firms.[15] The overall impact is ambiguous, but could be significant.

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11 Autio et al (2020), *On the Risk of Using a Firm-Level Approach to Identify Relevant Markets* discuss some current conceptual issues in market definition.

12 Condorelli and Padilla (2020), *Data-driven Envelopment with Privacy-Policy Tying.*

13 E.g. Abel et al (2019), *Monopsony in the UK*. Marinescu and Hovenkamp (2019), *Anti-competitive mergers in labor markets*.

14 Phillips and Zhdanov (2013), *R&D and the Incentives from Merger and Acquisition Activity.*

15 Kamepalli et al (2020), *Kill Zone*.