RBB | Economics

Consultation on the CMA Draft Merger Guidelines

A response by RBB Economics

RBB Economics, 07 January 2021

1 Introduction and executive summary

RBB Economics welcomes the CMA's public consultation on proposed amendments to its Merger Assessment Guidelines ("the Draft Merger Guidelines").

We are in full agreement with the following stated objectives of the Draft Merger Guidelines.

First, the CMA states that "*[c]onsumer interest is taken into account at every stage of the CMA's assessment of mergers, and is therefore implicit throughout these Guidelines, from considering the effect that any particular theory of harm might have on consumers, to weighing up relevant customer benefits that may arise as a result of a merger*".[1] This emphasis on consumer welfare is to be applauded as it should ensure that merger control remains focused on the effects of mergers on market outcomes in terms of price, quality and innovation. In so doing, that focus provides an established economic framework for assessing whether mergers are anti-competitive or pro-competitive.

Second, the CMA states that it is "*crucial that the CMA provides appropriate guidance to businesses considering entering into transactions which may have an impact on competition in the UK*".[2] We agree. Unless this fundamental objective is met, any Guidelines will be of limited value.

[1] Draft Merger Guidelines, paragraph 1.3
[2] *Ibid.*

However, despite these important areas of agreement, we have a number of serious concerns.

Lack of benchmarks

First, and most importantly, whilst the Draft Merger Guidelines identify the broad range of situations where the CMA considers that a merger may be problematic, they provide no practical benchmarks which firms (and their advisers) can use to determine when mergers are unlikely to give rise to competition concerns.

In particular, whilst all previous iterations of the CMA's Merger Guidelines provide an indication of market shares, competitor numbers and concentration measures that would not normally give rise to competition concerns, the proposed Draft Merger Guidelines remove these benchmarks and note instead that "[t]*he CMA does not apply any thresholds to market share, number of remaining competitors or on any other measure to determine whether a loss of competition is substantial*".[3]

While it is understood that the CMA cannot be prescriptive, it has sufficient experience of merger assessment to apply indicative benchmarks that would allow non-problematic deals to be identified with a reasonable degree of certainty. Guidelines should not be a treatise on when the CMA can intervene; rather they should indicate the CMA's normal practice and, in relation to more unusual interventions, the CMA should explain clearly when and why such departures from normal practice would take place.

Firms can only self-assess transactions accurately if the CMA provides information on what benchmarks will normally be applied to distinguish benign and pro-competitive mergers from anti-competitive mergers. The removal of such benchmarks will therefore significantly reduce business certainty with the likely consequence of deterring pro-competitive or competitively benign transactions.

In the absence of any benchmarks, the Draft Merger Guidelines inevitably fail to meet the CMA's stated objective of providing guidance to businesses.

Unfettered discretion

Given the ease of establishing jurisdiction with its share of supply test, and the limited scrutiny that the CMA faces from courts on substantive merger analysis, with an absence of meaningful benchmarks the CMA effectively grants itself near unfettered discretion as to whether a particular merger will be held to be problematic.

This unfettered discretion can be seen by the introduction of language indicating that the CMA may intervene when anything from a "not trifling" to "nearly complete" lessening of competition is deemed likely to arise. But the Draft Merger Guidelines provide no clarification of what

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[3] See CC & OFT *Merger Assessment Guidelines*, paragraph 5.3.5 (which sets out thresholds for market shares, the number of firms and the HHI), and Draft Merger Guidelines, paragraph 2.8.

standard will normally be applied.[4] They also state that an SLC may be found to be likely to arise even where the reduction in competition is "small", whilst providing no clarity on the definition of this wording.[5] Finally, the Draft Merger Guidelines also seem to establish a structural presumption against horizontal mergers in industries with "few" firms without indicating how "few" is to be defined.[6,7]

But is this increase in discretion (and potential increase in enforcement that may follow) either warranted or justified?

No evidence of under-enforcement

The CMA's apparent desire to reduce the threshold for intervention seems to be motivated by claims of past under-enforcement by the CMA in its application of UK merger control.[8] However, there is no reliable evidence to support such a claim in the UK. Which mergers does the CMA consider that it should have blocked and on what grounds? Which cases has the CMA cleared but now considers that it ought, on the basis of the evidence available at the time of review, to have prohibited or required remedies to protect consumers? Outside of the digital technology sector, we are unaware of any case where the CMA has expressed ex-post concerns that it had failed to intervene, let alone been prevented from intervening, resulting in actual adverse outcomes for consumers.[9,10]

And even in the digital sector, the evidence of under-enforcement is considerably less clear cut than proponents of increased enforcement claim.[11] For example, the ex-post assessment of merger control decisions in digital markets – the Lear Report – commissioned by the CMA, and cited in the Draft Merger Guidelines in support of under-enforcement, in fact provides a notably balanced view on whether the outcomes in these cases, including all the so-called "poster child" cases, ultimately harmed consumers.[12] A considered review of the available evidence clearly does not support the view that acquisitions in the digital technology industry provide obvious illustrations of under-enforcement.

Furthermore, since claims of under-enforcement appear to be almost solely driven by concerns raised by mergers involving digital technology firms, introducing a change to merger control that applies to all sectors of the economy is neither justified nor desirable. It is liable to cause unintended consequences from over-enforcement across the non-digital sector

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4 Draft Merger Guidelines, paragraphs 2.9 and 2.31.

5 The Draft Merger Guidelines indicate, at paragraph 2.9, that these conditions may apply where the market is large or is otherwise important to UK customers, or if there is only limited competition in the market to begin with.

6 The Draft Merger Guidelines note, at paragraph 4.9, that "*where competition mainly takes place among few firms, any two would likely be sufficiently close competitors that the elimination of competition between them would raise competition concerns, absent evidence to the contrary*". The CMA does not indicate what it means by "*few*" in this scenario.

7 In addition to these points, the Draft Merger Guidelines also discuss increased scrutiny of coordinated effects concerns (paragraph 6.5).

8 Draft Merger Guidelines, paragraph 1.7.

9 The CMA's *State of UK Competition Report* (2020) notably does not contain any suggestion that there has been under-enforcement in UK merger policy.

10 Even if a small number of cases of under-enforcement could be identified, this would not be sufficient to justify a change in merger standard. A lowering of the relevant standard is only justified if it can be demonstrated that this standard gives rise to substantially greater costs associated with false negatives than false positives

11 See Simon Bishop and Stephen Lewis, *How Merger Control Rolls: A response to Caffarra, Crawford and Valletti*, (forthcoming).

12 Lear, *Ex-post Assessment of Merger Control Decisions in Digital Markets*, 2019. See, for example, paragraph II.84

which, according to recent government figures, still accounts for over 90% of the UK economy.[13]

Over-enforcement of merger control entails costs to consumers and the UK economy

This leads to our final point; namely, that over-enforcement in merger control entails costs to consumers and the UK economy. Claims that the costs of over-enforcement are insignificant are unfounded.[14]

Mergers are an important part of the functioning of the competitive market process, allowing firms an efficient means of reducing costs (for example, by applying best practice methods), eliminating duplicate functions, obtaining access to technology or distribution, achieving scale economies or providing one way in which firms can respond to changes in technology, consumer preferences and numerous other factors that change over time. These benefits and efficiencies arising from mergers are much broader in nature than the marginal cost reductions on which an efficiency assessment tends to focus. Although it is appropriate that the merger assessment is concerned with efficiencies which are most likely to be passed on to consumers, these other benefits and efficiencies are also important to the efficient functioning of markets.

These important pro-competitive rationales for mergers often fail to be given due consideration in the arguments put forward by competition authorities seeking powers for easier intervention and in the individual assessment of transactions. Indeed, there appears to be a mistaken belief that the costs of over-enforcement (i.e. prohibiting pro-competitive mergers) are minimal. That, in turn, appears to be predicated in part on the belief that most mergers do not generate consumer benefits.

However, a close review of the evidence cited by the CMA does not support that proposition. Instead, the evidence supports the view that a significant share of transactions do deliver pro-competitive benefits to customers.[15] Indeed, the ex-post assessment of transactions in the digital sphere commissioned by the CMA points to the existence of important merger specific efficiencies.[16] The report of the Digital Competition Expert Panel – the Furman Report – also acknowledges that most mergers in digital markets will be competitively benign and that some may lead to significant efficiencies in the form of lower prices and increased innovation.[17]

What all these points, taken in the round, imply is that over-enforcement in merger control carries real, potentially very significant, costs for consumers and for the efficient functioning of

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13 See, for example, https://www.gov.uk/government/news/digital-sector-worth-more-than-400-million-a-day-to-uk-economy.

14 The CMA has provided no analysis or evidence that the costs of over-enforcement are minimal.

15 Kwoka, *Non-price effects of Mergers: Issues and Evidence*, 2018, indicates that 10 out of a sample of 26 studies of non-price effects showed that mergers gave rise to positive consumer outcomes. Kwoka, *Reviving Merger Control: A comprehensive plan for Reforming Policy and Practice*, 2019, which is referred to in the Draft Merger Guidelines, also references a McKinsey study showing that 93% of mergers achieve at least 75% of the cost savings estimated by management and that 39% of mergers achieve more than 100% of estimated cost savings.

16 See the Lear Report.

17 Furman et al., *Unlocking digital competition: Report of the Digital Competition Expert Panel*, 2019.

the UK economy. Put another way, over-enforcement serves to make markets work less well, in direct contravention of the CMA's stated mission.

The remainder of this response provides a series of detailed comments on the Draft Merger Guidelines and, where appropriate, sets out recommendations that (if followed) we believe would facilitate a more transparent and balanced approach to the assessment of mergers.

2 General observations on the Draft Merger Guidelines

The Draft Merger Guidelines discuss what might constitute an SLC and give examples of the theories of harm or broad conditions under which an SLC might arise. However, whilst the Draft Merger Guidelines identify a broad range of situations where the CMA considers that a merger *may* be problematic, they provide no practical *ex-ante* benchmarks which firms (and their advisers) can use to determine when mergers are *unlikely* to give rise to competition concerns. The Draft Merger Guidelines therefore fail to meet their primary objective of providing meaningful *guidance* to firms.

Relatedly, we note that the Draft Merger Guidelines enshrine a definition of the SLC test which offers the maximum discretion for intervention. As we discuss in this section, this increase in discretion (and potential increase in enforcement that may follow) is neither warranted or justified. An efficient merger control regime should balance the risks associated with "false positive" and "false negative" decisions, and there is no evidence that the current enforcement standards applied by the CMA fail to do this today.

2.1 New *Guidelines*, no *Guidance*

We have explained in Section 1 that the Draft Merger Guidelines propose a fundamental change from previous Merger Guidelines in terms of the level of guidance that is offered to merging parties and their advisers. In particular, whilst previous versions of the CMA's Merger Guidelines have provided an indication of market shares, competitor numbers and concentration measures that would normally not give rise to competition concerns, the Draft Merger Guidelines state instead that "[t]*he CMA does not apply any thresholds to market share, number of remaining competitors or on any other measure to determine whether a loss of competition is substantial*".[18,19]

Firms can only self-assess transactions accurately if the CMA provides information on what thresholds will normally be applied to distinguish benign and pro-competitive mergers from anti-competitive mergers. In the absence of any thresholds, the Draft Merger Guidelines inevitably fail to meet the CMA's stated objective of providing guidance to businesses.

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18 See CC & OFT Merger Guidelines paragraph 5.3.5 and Draft Merger Guidelines paragraph 2.8.

19 The Draft Merger Guidelines do note, at paragraph 2.17, that "[i]*t may be that the CMA finds an SLC if, for example: (a) the merger involves the market leader and the number of significant suppliers in a market is reduced from four to three*". Importantly, the Draft Merger Guidelines do not give an indication of whether a 5 to 4 might (absent other considerations) be unproblematic.

There is no good reason why the Draft Merger Guidelines cannot provide details of benchmarks below which transactions would not *normally* give rise to competition concerns, in order to allow firms to self-assess transactions.

The practical reality of recent UK merger control is that (for example) cases with combined market shares of less than 40% on the narrowest candidate market are not *usually* problematic (absent strong evidence of close competition) and that cases with combined shares of less than 30% are even less likely to be problematic. The CMA has sufficient experience in assessing mergers that it should be able to provide sensible benchmarks that would assist in identifying non-problematic transactions. This, in turn, would reduce the uncertainty facing businesses, as well as the costs associated with unnecessary notifications. It would also reduce the risk that benign or pro-competitive deals would be deterred as a result of the uncertainty created by the Draft Merger Guidelines. A discussion of the CMA's thinking on these and other relevant benchmarks (e.g. relating to competitor numbers, levels of concentration, diversion ratios or upward pricing pressure) should therefore be reintroduced into the Draft Merger Guidelines.

Recommendation 1: The Merger Guidelines should provide indications as to levels of market share, competitor number and concentration below which mergers will typically be held not to give rise to an SLC finding.

2.2 The "not trifling" to "nearly complete" lessening of competition test

In addition to removing practical benchmarks which firms can use to identify mergers that are generally unlikely to be problematic, the Draft Merger Guidelines also adopt an extremely broad and vague definition of what constitutes a substantial lessening of competition. In particular, the Draft Merger Guidelines indicate that the CMA may interpret a substantial lessening of competition as being anything in the range from "*not-trifling*" to "*nearly complete*" and provide no clarification on how the test will normally be interpreted.[20]

The CMA appears to believe that the current standard is "*well-understood*".[21] We disagree with this view. The semantic definition of an SLC has no direct link to any economic measure of the degree of competitive effect. This, coupled with a lack of discussion of benchmarks that could provide a practical indication of how this standard would be interpreted, increases both the complexity and uncertainty associated with any assessment of whether the effects of a merger are likely to be judged to be "substantial". The CMA should provide greater clarity on how an SLC would normally be judged by introducing a discussion of benchmarks which would meet this broad test.

To the extent that we *can* meaningfully interpret this broad definition, then (taken together with other statements made in the Draft Merger Guidelines) it affords the CMA an extremely broad degree of latitude when it comes to intervention.[22] Indeed, as all horizontal mergers reduce

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[20] Draft Merger Guidelines, paragraph 2.9.
[21] *Advice of the Digital Markets Taskforce*, paragraph 4.150, and Appendix F paragraphs 93, 97 and 115.
[22] See Section 1 above.

the number of competitors in a market, which could be claimed to be a "non-trifling" change, this definition would arguably give the CMA near unfettered discretion to intervene in these cases.

This attempt to maximise the CMA's discretion to intervene in merger cases (and the potential increase in enforcement that may result) appears to be motivated by two considerations. First, we understand that the CMA is concerned by claims of past under-enforcement in its application of UK merger control.[23] Second, CMA appears to consider that there are no significant costs to consumers from over-enforcement (i.e. preventing or deterring competitively benign or pro-competitive mergers), in part because it considers that most mergers do not generate efficiencies. We do not believe that the available evidence supports either proposition.

An efficient merger control regime should seek to balance the probability and costs of "false negative" decisions (i.e. incorrect decisions to clear anti-competitive deals, or "under-enforcement") and the probability and costs of "false positive" decisions (i.e. incorrect decisions to block deals that are not anti-competitive, or "over-enforcement"). A lowering of enforcement standards should, in turn, only be implemented if there is good evidence that the benefits of doing so, in terms of reducing under-enforcement, outweigh the costs, in terms of increased over-enforcement.

In terms of the potential benefits of reducing under-enforcement, we have noted that the CMA has presented no compelling evidence that there has been under-enforcement in the UK. Certainly, it has presented no evidence of *widespread* under-enforcement that would justify a change in the merger standard.

We understand that the CMA is concerned that it should have blocked so-called "poster child" cases of under-enforcement such as, for example, *Facebook/Instagram*. However, the Lear Report commissioned by the CMA, which is cited in the Draft Merger Guidelines in support of under-enforcement, in fact provides a notably balanced view on whether the outcomes of this and other digital mergers ultimately harmed consumers. It certainly does not support the view that these deals provide obvious illustrations of under-enforcement. For example, in relation to Facebook/Instagram, the Lear Report concludes that: "*Finally, whether the decision has ultimately harmed consumers also depends on the benefits accrued through the merger, which may have countervailed anti-competitive effects. Being able to monitor consumers' behaviour on its platform and on Instagram, Facebook can effectively target advertising and reduce inefficient ads duplications on its platforms. This may have generated 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*".[24]

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23 Draft Merger Guidelines, paragraph 1.7.

24 Lear Report, paragraph II.84.

Importantly, even if there was genuine under-enforcement of merger control in the digital sector, the Advice of the Digital Markets Taskforce (which, notably, was published after the Draft Merger Guidelines and therefore may understandably not be reflected in them) suggests that this can be tackled in a targeted way, without changing the standard for the remainder of the economy.[25]

Outside of the digital sector, we are unaware of any cases where the CMA has expressed *ex-post* concerns that it had failed to intervene appropriately, resulting in actual adverse outcomes for consumers. We note here that the CMA's recent State of UK Competition Report (2020) does not make any suggestion that there has been under-enforcement in UK merger policy and does not identify any cases that the CMA has failed to block which have resulted in anti-competitive outcomes. Were such cases to exist, we would expect that the CMA would have considered it to be important to report these to Parliament.[26]

Moreover, we note that, even if a small number of cases of under-enforcement could be identified, this would not be sufficient to justify a change in standard. As we have observed above, an efficient merger control regime is one that appropriately balances the risks and costs associated with false negative decisions and false positive decisions. A lowering of the bar for enforcement would therefore only be justified if it can be demonstrated that there is widespread under-enforcement such that the cost of false negatives exceeds the cost of false positives. The CMA has not offered evidence that indicates this is the case.

If the CMA indeed has evidence of anti-competitive outcomes arising from a failure to intervene in cases that is linked to constraints it faces as a result of a more narrowly defined version of the SLC test, then it would be helpful if this evidence could be presented. Absent such evidence, we believe there is no sound justification for introducing Merger Guidelines which afford the CMA the maximum scope for intervention at the expense of providing meaningful guidance to firms.

In terms of the potential costs of increasing over-enforcement, the CMA has no evidence that the costs of over-enforcement "outweigh the potential risk of harm".[27,28] On the contrary, even the evidence cited in the Draft Merger Guidelines indicates that a significant proportion of mergers generate positive outcomes for consumers as a result of efficiencies. The ex-post assessment of transactions in the digital sector commissioned by the CMA also points to the existence of important merger-specific efficiencies. These benefits would be lost if benign or pro-competitive mergers were deterred or incorrectly blocked.

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25 See section 4 of the *Advice of the Digital Markets Taskforce*. The Advice sets out the view (at paragraph 4.125) that "*the UK merger control regime remains broadly fit for purpose*" other than in digital markets. The Advice recommends "*a distinct merger control regime for SMS firms*", i.e. those firms with "Strategic Market Status", under which "[c]*ompetition concerns would be assessed using the existing substantive SLC test, but to a lower and more cautious standard of proof*".

26 CMA, *State of UK competition report* (2020).

27 The CMA has made bold, but unsubstantiated, claims on this point. See Financial Times, 8 December 2020, *UK watchdog plans global revenue fines if Big Tech behaves badly*.

28 The evidence cited in the Draft Merger Guidelines - namely Kwoka (2018) - supports the view that not all mergers will give rise to pro-competitive effects but, importantly, also indicates that a significant number will do so. See Section 8.1 below for more details.

We consider this evidence in more detail in Section 8.1 of this response, where we discuss the role of efficiencies in the overall assessment of mergers.

In summary, we consider that the SLC test, as defined in the Draft Merger Guidelines, is vague, hard to interpret, and implies an extremely broad discretion to intervene against mergers which is not justified. The CMA should reconsider its treatment of this element of the Draft Merger Guidelines.

Recommendation 2: The Merger Guidelines should provide a clear definition of an SLC that it would normally apply in most cases. This definition should be linked to benchmarks that assist in identifying non-problematic and problematic mergers.

2.3 "Small" SLCs

In addition to the interpretation of the SLC test, the Draft Merger Guidelines also indicate that the CMA may view a lessening of competition to be substantial even when it is "*small*". This lower threshold may be applied where "*the market to which it applies is large or is otherwise important to UK customers, or if there is only limited competition in the market to begin with*".[29] We have three key concerns regarding the inclusion of this "small" SLC criterion in the Draft Merger Guidelines.

(i) Small is not defined by the CMA

The CMA provides no discussion of how the term "small" should be interpreted in practice. The Draft Merger Guidelines therefore offer no practical guidance on how this test will be applied.

Distinguishing between small SLCs that are not problematic and those that are is of particular importance in cases where the CMA relies on simple theoretical models such as the GUPPI to analyse the effects of mergers. Such models will of course (absent explicit allowances for efficiencies) *always* predict a positive price effect from a horizontal merger. However, we believe that the CMA recognises that identifying a small degree of upward pricing pressure, for example, does not automatically translate into price increases.[30] In other words, a GUPPI of 1% does not indicate a price rise that is 10 times smaller than a GUPPI of 10%. Rather, in many cases it would suggest that a price rise may not result at all. In these cases, we consider that it is even more important for the CMA to provide clarity on the criteria that might be used to distinguish good mergers from bad.

More generally, it might be argued that any horizontal merger would give rise to a "small" lessening of competition in the sense that one competitor is removed from the market. As drafted, the Draft Merger Guidelines might therefore be understood to mean that, in large or important markets or markets where there is limited competition, there is effectively a

29 Draft Merger Guidelines, paragraph 2.9.

30 We note that the CMA clears many transactions that would give rise to positive pricing pressure according to the GUPPI. There are many reasons for this including, for example, efficiencies, dynamic responses, the ways firms set prices in practice, and the effects of intermediaries such as retailers all not being captured explicitly/adequately.

prohibition on horizontal mergers. Assuming that the CMA does *not* intend to impose a standard which results in all transactions in these markets being prohibited, the language in the Draft Merger Guidelines should be clarified. For example, in keeping with our suggestion to provide benchmarks for when a typical merger is likely to be viewed as problematic, the Draft Merger Guidelines might illustrate how those benchmarks would vary with the size of the affected market.

Recommendation 3: The Draft Merger Guidelines should clarify the benchmarks that will be used to assess when a lessening of competition is sufficient in scale for an SLC to arise. This is of particular importance when simple theoretical pricing pressure models (which will always predict a price increase absent efficiencies) are employed.

(ii) The large or important market criteria

With regard to "large" or "important" markets specifically, we understand the CMA to mean that the same effect on competition (e.g. the same level of upward pricing pressure) is more likely to be "substantial" (in terms of its absolute effect on consumers) in larger or important markets. This, in turn, may reflect a concern that there is a disconnect between the CMA's test, which relates to competition, and its primary duty, which relates to protecting consumers, and we assume that the CMA intends to reflect this duty in the standards it sets for the test.

If this is the CMA's intention, the Draft Merger Guidelines should provide guidance on how an "important" market will be identified. In particular, whilst the Draft Merger Guidelines refer to *Sainsbury's/Asda*, in which the CMA took account of the fact that that groceries were "*a non-discretionary expenditure that accounted for a significant share of household spend*", they provide no information on whether these are the only criteria that would apply or what constitutes a "significant" share of spend.[31] Further clarification of these criteria would help merging parties assess when these tougher standards will be applied. For example, in line with the approach taken by other authorities, the CMA could provide a clear list of markets which would fall within this definition (or at least specify clearly the criteria for their inclusion).

Additionally, *if* it is true that the CMA would be more concerned that a given effect on competition is "substantial" and worthy of intervention in markets that are large or otherwise important to UK consumers, it must presumably follow that the same effect is less likely to be considered substantial in smaller markets. In the interests of balance, the Draft Merger Guidelines should clarify whether the CMA will consider that any given lessening of competition is *less* likely to be substantial in markets that are relatively small, including via the *de minimis* exception.

Recommendation 4: The Merger Guidelines should clarify what markets will be included in the definition of "large or important markets" and consider the implications of this approach for other markets.

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[31] Draft Merger Guidelines, footnote 24.

(iii) The limited competition criterion

With regard to the "limited competition" criterion, the Draft Merger Guidelines are unclear on whether this refers to a situation where the *scope* for competition is limited (for example, due to regulation), or where the *degree* of competition is limited (because there are few pre-merger players). The example given is pharmacies, where many parameters of the offering are regulated. This leads us to understand that the CMA is referring to the former. Assuming this is correct, the CMA should clarify that its intention with this wording is to capture situations where not all parameters of competition may be affected by a merger, but the merger is expected to give rise to a worsening of terms in relation to those parameters that can be flexed, *and* that those parameters are important to consumers.

Recommendation 5: The Merger Guidelines should clarify precisely what the "limited competition" criterion refers to.

3 Market definition

In relation to market definition, the Draft Merger Guidelines depart from previous versions in three notable respects.

- First, they signal a diminished role for market definition in the overall merger assessment process, with greater emphasis to be placed on direct assessment of competitive effects. (Demoting discussion of market definition to the final section of the Draft Merger Guidelines is symbolic in that regard.)
- Second, they appear to question the status of the hypothetical monopolist or SSNIP test as the basis for market definition in competition cases.
- Third, they appear to limit full and proper consideration of supply-side substitution as part of the market definition assessment.

These proposed changes raise significant concerns. The definition of the relevant market plays an important role in the sound assessment of mergers and we therefore urge the CMA to reconsider its approach.

3.1 The role of market definition

The Draft Merger Guidelines accept that market definition "*can be an important part of the overall merger assessment process*".[32] Indeed, the CMA recognises that it is "*required to identify the market or markets within which an SLC exists*".[33] However, the Draft Merger Guidelines go on to downplay significantly the role of market definition, noting, for example,

32 Draft Merger Guidelines, paragraph 9.2.
33 *Ibid.*, paragraph 9.1.

that "*the CMA anticipates that in future, merger assessments will place more emphasis on the competitive assessment as opposed to static market definition*".[34]

We agree with the Draft Merger Guidelines that market definition is not an end in itself. Rather, it forms an integral part of the overall analysis of the competitive effects of a merger, alongside the competitive assessment. Market definition, undertaken soundly, provides an essential appraisal of the extent of demand-side and supply-side substitution. It establishes the context within which a rigorous, comprehensive competitive assessment can be undertaken. As such, market definition and competitive assessment play valuable complementary roles.

Moreover, notwithstanding the fact that a proper economic assessment of competition cannot be confined to a structural analysis, as a practical matter market shares still play an important role in merger assessment. Whenever market shares are used as a proxy for a firm's competitive significance (as the CMA regularly does), it is critical that they are calculated for a market that is defined rigorously according to the hypothetical monopolist test, following sound principles to identify the relevant competitive constraints.[35] Shares calculated on an arbitrary alternative basis are just that – arbitrary.

It might be argued that the strictures of market definition limit the CMA's ability to "*take into account constraints outside the relevant market*".[36] However, we think the more serious concern in practice is that the focus of the CMA's assessments has often been unduly narrow, and that an emphasis on consideration of out-of-market constraints risks encouraging that, by downplaying both the importance of getting market definition right and the risks associated with overly narrow market definitions, in particular. Rigorous market definition should not, and need not, prevent proper consideration of out-of-market constraints.

It is striking that the CMA contrasts competitive assessment with "*<u>static</u> market definition*" (emphasis added).[37] We believe the reality is quite different. A significant concern is that the analyses undertaken by the CMA as part of its competitive assessments are frequently extremely static, with insufficient consideration given to supply-side dynamics. In contrast, market definition – at least when undertaken properly, according to the hypothetical monopolist test – is *explicitly* framed in terms of, and requires consideration of, the responses of customers <u>and</u> potential new suppliers to *changes* in competitive conditions. Further, the process of market definition necessarily involves an evaluation of supply-side reactions within and constraint from outside the market ultimately adopted (see further Section 3.3 below). As such, it provides a basis for considering supplier repositioning within that market, as well as entry from outside it.

In principle, the comprehensive analysis of supply-side and demand-side constraints that rigorous market definition entails could be undertaken under the "competitive assessment" label. In practice, however, our experience is that the CMA has often approached competitive

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34 *Ibid.*, paragraph 9.2.
35 Of course, as noted, there may be cases where the exact market definition is not decisive to the competitive assessment.
36 Draft Merger Guidelines, paragraph 9.4.
37 *Ibid.*, paragraph 9.2.

assessment with a narrow focus on the pre-existing “closeness” of the merging parties. In that light, we think it is unlikely that competitive assessment will suddenly become sufficiently comprehensive. Crucially, if the relevant considerations are to be addressed properly in any event, we see no reason why market definition should be treated as superfluous. Indeed, a commitment to the discipline of rigorous market definition – undertaken according to the hypothetical monopolist test, with appropriate emphasis on supply-side as well as demand-side considerations – is vital in our view.

The impact of market definition on the overall assessment of a merger will vary and can be more or less decisive, depending on the nature of the case and the totality of relevant evidence available. In some cases, the overall assessment will not be sensitive to the exact market definition adopted. That includes cases where analysis at the competitive assessment stage is robust and decisive irrespective of the market definition adopted. However, not infrequently in our experience, the extent of the analysis undertaken by the CMA at the competitive assessment stage is limited and market definition plays a decisive role in the overall assessment. The Draft Merger Guidelines must set out a framework that is fit-for-purpose in such scenarios.

Importantly, market definition is uncontroversial in many cases and the resulting market shares, etc. provide relevant indicators of competitive conditions. For instance, the existence of a large number of competitors within a well-defined market may provide comfort that any static loss of competition is likely to be effectively made good through the (hard to model) dynamics of competition, ensuring that consumers are protected from increases in price or equivalent reductions in quality. In these cases, market definition would provide an important check and balance on the predictions of direct economic models of static competitive effects.

Recommendation 6: The Merger Guidelines should reaffirm the CMA’s commitment to undertaking a proper market definition exercise as part of every merger assessment. The CMA should also reaffirm the importance of considering likely reactions by customers and other suppliers to small but significant changes in price (or equivalent changes in quality) as part of that exercise.

3.2 The hypothetical monopolist test as <u>the</u> basis for market definition

The hypothetical monopolist test provides <u>the</u> basis for undertaking rigorous market definition in competition cases. The test provides the conceptual framework for organising and assessing evidence on substitution. Its value does not depend on being able to implement the test as a formal mathematical test, or on access to large amounts of data.

The Draft Merger Guidelines do refer to the relevance of responses to “*a small but significant increase in price*”.[38] However, this is not framed clearly in terms of the hypothetical monopolist test. Moreover, the Draft Merger Guidelines appear to suggest alternative, looser approaches – for instance, “*describing the market as comprising the most important constraints on the*

[38] Draft Merger Guidelines, paragraph 9.7.

merger firms that have been identified in the CMA's assessment of competitive effects".[39] The Draft Merger Guidelines also note that the CMA "*may calculate concentration measures on multiple different bases, including and excluding different firms, depending on which firms the CMA wishes to compare*".[40]

Worryingly, that suggests a process whereby the hypothetical monopolist test framework is not followed and where market definitions are "retrofitted' to support the conclusions of the competitive assessment – removing two of the key functions of market definition, namely to frame the competitive assessment appropriately, and also to provide an important check on it.

Recommendation 7: The Merger Guidelines should acknowledge that the hypothetical monopolist test provides the basis for defining relevant markets in competition cases.

3.3 The relevance of supply-side substitution

The Draft Merger Guidelines appear to contemplate a role for supply-side substitution as primarily a device for rationalising (or "aggregating") the analysis of multiple, competitively similar markets.[41]

In our view, substantive evaluation of supply-side substitution remains an essential component of rigorous market definition. Quite simply, without it, individual markets may be defined too narrowly. Its relevance, therefore, is not restricted to aggregating different relevant markets for convenience purposes.

In principle, a comprehensive and rigorous analysis of supply-side considerations at the competitive assessment stage should, ultimately, lead to the same conclusions as would incorporating such analysis in the market definition assessment. In practice, however, the potential supply-side responses that may be relevant to an assessment can vary greatly, ranging from those that require only minor adjustments to existing supply arrangements and can be made quickly, through to responses that involve substantial new investment and may take longer to implement. Crucially, in some cases supply-side responses already impose a relevant competitive constraint (sufficient to be considered as part of the relevant market), even if they would not be caught up in the aggregating process mentioned above. In other cases, they do not. This is an important distinction. The treatment of supply-side substitution as part of market definition and consideration of potential competition and entry more broadly as part of the competitive assessment offers a means of identifying important sources of competitive constraint that are not currently significant demand-side substitutes.

As set out above, we believe that retaining rigorous market definition as a distinct step in the overall merger assessment is important, not least because the "frame of reference" that is adopted does shape the nature of the competitive assessment in practice. Undertaking a

[39] *Ibid.*, paragraph 9.5.
[40] Draft Merger Guidelines, paragraph 9.3.
[41] *Ibid.*, paragraph 9.8. In the classic illustration, this might allow the CMA to avoid having to analyse multiple markets for differently-sized shoes, for example, simply because shoes of different sizes are not demand-side substitutes.

rigorous evaluation of supply-side substitution is a necessary part of that market definition process.

Recommendation 8: The Merger Guidelines should acknowledge the important role of supply-side dynamics and reflect this in the discussion of market definition.

4 Horizontal unilateral effects

With respect to horizontal unilateral effects, the Draft Merger Guidelines codify the information that the CMA will take into account in its competitive assessment and identify a broad range of circumstances where an SLC may be identified.

We have noted in Section 2 our concern that by removing benchmarks and providing no clarity on how the CMA will interpret its substantive test, the Draft Merger Guidelines fail in their primary objective of providing guidance to businesses and grant the CMA an unjustified, near unfettered discretion to intervene against mergers. These concerns apply most significantly to standard horizontal mergers.

In addition to these general comments, we have a number of specific concerns with the CMA's discussion of the circumstances in which horizontal unilateral effects concerns are likely to arise which we address in this section.

4.1 Unilateral effects in concentrated markets

The Draft Merger Guidelines state that "*where competition mainly takes place among few firms, any two would likely be sufficiently close competitors that the elimination of competition between them would raise competition concerns, absent evidence to the contrary. 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*".[42]

As drafted, this amounts to a structural presumption that mergers in relatively concentrated markets (however that is defined) will be deemed to be problematic that is not justified by historical experience. This is even more concerning as the Draft Merger Guidelines do not indicate how many firms would typically need to be present for a market to fall outside this definition. Moreover, as noted above, the CMA does not constrain itself to adopting an objective framework for market definition (and hence for identifying relevant market structure).

Crucially, whilst it is true that unilateral effects concerns are (all else equal) more likely to arise where there are fewer competitors, there are also sound economic reasons why horizontal mergers need not give rise to harmful effects even in relatively concentrated markets. That may be the case, for instance, where a merger involves competitors that are sufficiently small

[42] Draft Merger Guidelines, paragraph 4.9.

and/or differentiated, or owing to dynamic responses of existing or potential competitors. Indeed, there are many examples of cases that have been cleared due to a lack of closeness of competition, despite there being only a small number of competitors.

For example:

- in *Menzies/Airline Services,* the CMA cleared a merger that amounted to a '3 to 2' in de-icing services at certain airports, on the basis that the parties did not constitute actual or potential competitors for contracts.[43]
- Similarly, in *Dechra/Elanco,* the CMA cleared a merger that gave rise to historically high shares in the market for the treatment of canine otitis on the basis of diversion ratio evidence showing that the Parties' products did not compete closely.[44]

If the CMA's intention is to change its approach to the assessment of unilateral effects such that these cases and others would now be blocked or remedied, then it should present evidence that its current standard has resulted in it clearing cases which have given rise to real consumer harm.

If this is not the CMA's intention, then the Draft Merger Guidelines should be amended to reaffirm the CMA's commitment to the evidence-led approaches adopted in these cases, rather than applying structural presumptions in its assessments.

Recommendation 9: The Merger Guidelines should state that the CMA will undertake a detailed assessment of closeness of competition in concentrated markets.

4.2 Small increments

The Draft Merger Guidelines also indicate that "[w]*here one merger firm has a strong position in the market, even small increments in market power may give rise to competition concerns*".[45]

There is no disagreement that smaller increments may be more problematic in those cases where a firm already has a strong market position. For example, consider the case of a firm with an 80% market share buying one of four remaining competitors each of which holds a market share of 5%. In this case, one may want to apply a cautious standard in order to protect remaining competition in the market, especially in circumstances where the target shows signs of potential to develop into a more material competitor going forward and barriers to entry and growth for rivals are high.[46]

Set against this, there are many cases that will not meet these criteria despite potentially satisfying the definition set out by the CMA in the Draft Merger Guidelines. Consider, for

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[43] *John Menzies plc and Airline Services Limited*, see sections on de-icing services at EDI and GLA, concluding "*Overall, the evidence indicates that the Parties do not compete at EDI or GLA*" (paragraph 61).

[44] *Dechra Pharmaceuticals PLC/Osurnia business of Elanco Animal Health Incorporated*, particularly paragraphs 8, 80 and 96.

[45] Draft Merger Guidelines, paragraph 4.11a.

[46] For example, Illumina, Inc. / Pacific Biosciences of California, Inc, where PacBio had a market share of less than 5%, but was expected to grow, and Illumina had a share in excess of 80%.

example, a case where a supplier of branded consumer goods with a market share of 50% acquires a competitor with a 1% share. The acquisition of a marginal player whose products are demonstrably rarely purchased by consumers is extremely unlikely to substantially enhance the ability of the acquirer to negotiate increased prices with retailers in this case (that negotiating strength will be driven by the existence of more important brands that the acquirer already held in its portfolio). Equally, any attempt to raise prices for the acquired brands is unlikely to be successful: retailers can delist these marginal products in response to this strategy.[47] These cases should not give rise to a presumption of concern, as seems to be suggested by the Draft Merger Guidelines.

Recommendation 10: The Merger Guidelines should provide more guidance on the situations when small increments could be problematic. This could be achieved by reference to illustrative market share scenarios that might identify potentially problematic and unproblematic mergers.

4.3 Margins

In relation to margins, the Draft Merger Guidelines reaffirm the CMA's standard approach of using variable accounting margins as an indicator of the value of sales that would be diverted between firms following a price increase and consequently of unilateral effects. The Draft Merger Guidelines also give new examples of how context may affect the interpretation of evidence. For example, footnote 77 says that even if accounting margins are low, the value of recaptured sales may be high "*if sales have strategic value or contribute to a firm's ability to make greater future profits – for example, if those sales contribute to the firm's reputation, brand awareness, customer loyalty, or network effects*".

We do not agree that margins are reliable indicators of the competitive effects of horizontal mergers – and relying on the size of margins as an indicator of competitive effects is certainly no substitute for seeking to understand the competitive process.

For example, consider the case of software markets. In these markets, the costs associated with physically producing and supplying additional units of software are often extremely low. In turn, accounting margins (when measured as the difference between a firm's revenues and "costs of goods sold") may be very high.

However, software firms will also typically incur significant costs associated with (i) hiring and incentivising (via bonus payments) large sales teams to generate new business; and (ii) hiring specialists to provide customer support. These costs do not feature in a standard accounting estimate of variable costs, but they are important for understanding how firms compete, and vary with the number of customers served.[48] Therefore, an analysis of accounting margins

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[47] In *Diageo/United Spirits* the CMA cleared the acquisition of the Vladivar brand with a share of 0-10%, by the owner of the market leading brand (Smirnoff, with a share of 45-55%) due to "*Vladivar being a small brand, the lack of significant third party concern, and the continuing constraint from other competitors in each channel*".

[48] Where software companies offer bespoke deployments of their software, customer support costs will increase and decrease with the number of customers. Bonus payments will also vary directly with the number of new customers that purchase software.

would significantly understate the value of variable costs and overstate the value of diverted sales.

But more importantly, software firms also invest significantly on an ongoing basis to improve their product offering in order to win new customers from competitors (and retain existing customers). As a result, it is not uncommon for firms to generate very small (or even negative) levels of total profit despite their seemingly healthy variable accounting margins. In circumstances where firms reinvest most or all of their profits in order to improve their products each year due to the existence of strong competitive alternatives, it would be wrong to equate high variable margins with a lack of competitive constraint.

Put simply, margins can be a misleading indicator of the competitive effects of horizontal mergers. A focus on margins risks failing to conduct a more complete analysis of the role of competition in driving incentives to invest and innovate (and how a merger would affect these).

Recommendation 11: The Merger Guidelines should acknowledge that margins may be a misleading indicator. They should explain when the CMA will consider margins to be important and, in those cases, which measures of margin are relevant and how they are appropriately measured. The Merger Guidelines should also offer examples of how using accounting variable margins may cause merger concerns to be overstated (or indeed understated).

4.4 Local mergers

The CMA's approach to local mergers has historically focused primarily on local overlaps, with a purely national approach taken only rarely, and after detailed consideration at Phase 2. The Draft Merger Guidelines appear to indicate that the CMA will try to understand better how firms actually think about competition and will not undertake a time consuming and costly local analysis in all cases.[49] These proposals are to be welcomed.

Nevertheless, it would be helpful if the Draft Merger Guidelines could describe how the CMA anticipates this approach would work in practice, in particular how and at what stage the CMA will decide if merging parties compete at the national level. This clearly has the potential to streamline the assessment process for local mergers considerably, but only if firms can be sufficiently confident of the CMA's approach to be able to avoid preparing a local assessment as part of their draft Phase 1 Merger Notice.

We note that the CMA has considerable experience in assessing local mergers in a range of industries (including, inter alia, pubs, pharmacies, petrol stations, groceries, betting and clothing retail). It would seem relatively simple for the CMA to codify which approach it would normally expect to take in these sectors at least.

[49] Draft Merger Guidelines, paragraph 4.27.

The Draft Merger Guidelines indicate that, where a filter has been applied and a large number of local areas remain for further consideration, there may be limited time available to conduct a detailed competitive assessment of those areas. Nonetheless, the CMA should "reality check" the filters that it uses to ensure they capture competitive conditions meaningfully.[50]

Recommendation 12: The Merger Guidelines should provide a provisional view on which sectors are likely to be assessed locally vs nationally and, for other sectors, describe the process for agreeing an approach with merging parties prior to notification.

5 Potential competition

The Draft Merger Guidelines set out a significantly enhanced discussion of theories of harm centred on effects on potential future competition.[51] The additional insight provided into the CMA's approach to these issues is to be welcomed. However, as we discuss below, there are several refinements to the discussion which we consider would improve the relevant economic assessment.

5.1 Loss of potential future competition

The first of two main theories of harm involving potential future competition discussed in the Draft Merger Guidelines relates to the concern that *"a merger involving a potential entrant may imply a loss of the future competition between the merger firms after the potential entrant would have entered or expanded".*[52]

When assessing this theory of harm, the Draft Merger Guidelines state that "[t]*he CMA's assessment of competitive effects from the loss of the future competition between the merger firms is similar to its assessment when the merger firms are existing suppliers (see Chapter 4), except that the CMA's assessment will reflect the future competitive conditions expected after entry or expansion by the merger firms has taken place*".[53] The Draft Merger Guidelines go on to state that "[t]*he CMA will take into account entry or expansion by non-merging rivals over a similar time horizon as the merger firms' entry or expansion*".[54]

This latter consideration is essential when assessing theories of harm based on future competition. In particular, if the CMA believes that entry by the merging party is realistic, this in turn implies that barriers to entry are surmountable, that customers are willing to switch and/or the market is growing such that entry is attractive. A balanced assessment of the prospects of entry and expansion from third parties is therefore essential to assess whether competition concerns may arise.

50 See RBB Brief 60: *Sainsbury's/Asda and the CMA's GUPPI decision rule: On the money or basket case?*
51 We note that the use of "potential competition" in these scenarios risks confusion with the analysis of the potential for countervailing entry in response to a post-merger increase in prices.
52 Draft Merger Guidelines, paragraph 5.2.
53 *Ibid.*, paragraph 5.14.
54 *Ibid.*, paragraph 5.15.

However, the Draft Merger Guidelines leave unanswered the important question of how the prospect of third-party entry will be judged, i.e. against what standard, at each of Phase 1 and at Phase 2. In particular:

- it is unclear whether the factors and evidence applying to "the potential entrant" in paragraph 5.16 will be considered equally for third party entrants as well as for the merging party. For example, will the CMA assess whether the potential third party entrant "*has any features that would affect how well-placed it is to enter, such as existing customer relationships from related products that could enable it to cross-sell or bundle them to gain scale quickly*"? The Draft Merger Guidelines do not confirm if these standards will be applied when assessing entry by the merging parties; and
- the Draft Merger Guidelines do not specify whether, in these cases, the constraint from third party entry and expansion will be judged against the normal "timely, likely and sufficient" standard applied by the CMA in normal horizontal mergers. If this approach were taken, we are concerned that it would create a dual standard whereby entry by third parties was assessed against a different evidentiary standard to that used to assess the constraints from potential entry of the merging party.

The Draft Merger Guidelines should codify more clearly the CMA's approach to assessing entry of third parties and should affirm a clear commitment to applying the same evidentiary standards when assessing third party entry as it uses when assessing the scope for entry by the merging parties. This should, in turn, assure that the CMA will engage in a balanced assessment of these theories of harm going forward.

Recommendation 13: The Merger Guidelines should explicitly discuss the importance of undertaking a comparative assessment of the prospects of entry of the target and third parties and confirm that the evidentiary standard will be the same in both cases.

Additionally, the Draft Merger Guidelines indicate that, when assessing losses of future competition in cases where one merging party has a strong position in the market, "*even small increments in market power may give rise to competition concerns and, therefore, the acquisition by any such firm of a potential entrant may be concerning even if its impact on competition is uncertain, or expected to be small*".[55]

We have discussed in the context of horizontal unilateral effects the caveats and clarifications that should be applied when assessing small increments and when contemplating whether small increments can give rise to a substantial lessening of competition.[56] These considerations apply equally to potential competition theories of harm.

Finally, we are surprised that the CMA would suggest that a substantial lessening of competition may arise in a potential competition scenario if the impact of an entrant *on*

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55 Draft Merger Guidelines, paragraph 5.15.

56 See Section 4.2.

competition is "*expected to be small*".[57] The impact on competition is directly what we seek to assess in merger cases and if that impact can be said to be small then (absent special considerations) it seems to us incongruous to claim it would be substantial. We consider that either this language should be removed, or the Draft Merger Guidelines should clarify under what circumstances this might arise. If the CMA persists in retaining such language, then it should at the least make clear that, in this case, third-party potential entrants would be just as important as the merging party deemed to be a potential entrant, even if the impact of third-party entrants on competition is "expected to be small".

Recommendation 14: The Merger Guidelines should provide guidance on the level of increments that would not give rise to potential competition concerns and confirm that an SLC will not arise when the effect of future entry by one of the merging parties on competition is expected to be small.

5.2 Loss of dynamic competition from potential entrants

The second theory of harm discussed in the Draft Merger Guidelines under the potential competition heading is referred to as a loss of "dynamic competition", where "*existing firms and potential competitors can interact in an ongoing dynamic competitive process*", and current investments and innovation effort lead to entry or expansion. This may encompass a range of possible issues, which are difficult to capture within a single framework, and on which the Draft Merger Guidelines therefore offer relatively little guidance. We therefore restrict our comments to two particular issues.

First, the Draft Merger Guidelines give a one-sided discussion of incentives to innovate in markets where incumbents invest to protect their existing market positions from new entrants, whilst entrants must invest to penetrate the market. They correctly note the **cannibalisation effect**: products resulting from innovation by one merging party may cannibalise the profits of the other merging party and, once this effect is internalised as a result of the merger, both parties' incentive to innovate may be reduced.

However, they fail to mention the opposing **appropriability effect**: a firm will invest in costly innovation only if the expected rewards exceed the cost. If a merger increases appropriability, for example by internalizing knowledge spillovers between the merging parties, it may enhance the merging parties' incentives to innovate.

The academic literature provides no general consensus on the impact of mergers on innovation incentives. Assessing the impact of a merger on R&D investments therefore requires a complex balancing of a number of factors that affect the incentives to innovate, most notably cannibalisation and appropriability.[58] This is not discussed at all in the Draft

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[57] This is, of course, different to the claim that a small increment can give rise to a substantial effect on competition as a result of a lack of other constraints.

[58] See RBB Brief 54: *An innovative leap into the theoretical abyss: Dow/DuPont and the Commission's novel theory of harm.*

Merger Guidelines. It cannot be valid simply to presume that one of these opposing effects dominates the other.

Second, the Draft Merger Guidelines provide little practical guidance on how dynamic theories of harm will be assessed in practice, with the discussion limited to just two paragraphs.

The Draft Merger Guidelines note in the first instance that "*the CMA may consider evidence on any direct response of an incumbent merger firm to the threat of entry or expansion by the other merger firm or may consider evidence on the incumbent's incentive to respond to any such threat*".[59] This seems sensible, but – as with the analysis of loss of potential future competition – the Draft Merger Guidelines do not explain how the CMA will take into account the threat of entry by third parties that may also be innovating with a view to entering the acquirer's market. The Merger Guidelines should clarify that a broader assessment is necessary to determine if any loss of potential dynamic competition is likely to give rise to an SLC, and to ensure that third parties are treated in an equivalent way, to the same standard, as the merging parties.

The Draft Merger Guidelines then go on to state that "[t]*he 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*".[60] However there are strong reasons to expect that it is unlikely that a substantial lessening of competition would occur in these circumstances. In particular, where the incumbent believes that entry is "*unlikely*", one would not normally expect this "unlikely" prospect to be a key driver of the incumbent's innovation efforts.[61] More generally, if an incumbent is genuinely constrained and incentivised to innovate strongly by an amorphous (but unlikely) "threat" of entry then, absent strong evidence that the target is a unique constraint, this should provide a reason why anti-competitive outcomes are *unlikely* to arise, rather than a reason to block a merger. The incumbent would continue to be constrained by the (unlikely) threat of entry from a wide range of other players. The CMA should therefore reconsider the language around "unlikely" entry in relation to this theory of harm in the final version of its Merger Guidelines.

Recommendation 15: The Merger Guidelines should recognise that some mergers may have opposing influences on incentives to innovate, and that these need to be weighed against each other. They should also take into account the threat of entry from other market participants in an equal way, and reconsider whether SLCs can arise when the target is in reality unlikely to enter a market successfully.

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59 Draft Merger Guidelines, paragraph 5.22.

60 *Ibid.*, paragraph 5.23.

61 If the CMA has in mind a situation where pre-merger entry is unlikely because of ongoing innovation by the incumbent but would become likely if those efforts were relaxed, then it would still be important for the CMA to evidence the fact that entry would indeed be likely in this scenario absent the merger. Otherwise, it is hard to see how the target could be said to be the driver of that innovation.

6 Coordinated effects

In relation to coordinated effects, the Draft Merger Guidelines suggest that there is a "*growing body of evidence that coordination in concentrated markets is common and has the effect of restricting competition and raising prices*" and that the CMA will therefore "*consider seriously the impact of mergers in concentrated markets on the potential for firms to coordinate*".[62]

It is, of course, correct that the CMA should consider coordinated effects concerns thoroughly. However, the Draft Merger Guidelines provide an unbalanced view of the likelihood of such concerns and set out an unduly low standard for intervention, including, most worryingly, an apparent structural presumption of anti-competitive effects from horizontal mergers in markets which exhibit evidence "consistent with" coordinated outcomes. This is unjustified.

The CMA also fails to acknowledge that the three conditions for coordinated effects (ability to reach a common understanding, internal stability, and external stability) are *cumulative*.[63] Further, even if a merger makes it more likely that one criterion will apply, the CMA must recognise that there is a fundamental difference between making coordination "more likely" (which is true if the probability of coordination increases from 15% to 20%) and making coordination *likely* (which means a probability in excess of 50%). We discuss these points in more detail in this section.

6.1 The state of the evidence on coordinated outcomes in markets

The Draft Merger Guidelines include strong statements suggesting that there is increasing support for the view that coordinated outcomes are common, citing two papers in support of this view.

Whilst a full review of the literature on coordination is beyond the scope of this response, we note that Baker and Farrell (2020) rely on a limited set of real-world evidence in support of the view that tacit coordination is "common", comprising selective citations of studies of tacit collusion covering six industries.[64] While we do not dispute that coordinated outcomes may occur in some industries, this evidently does not provide a strong basis for the conclusion that coordination is "common" or under-enforced.

Moreover, we note that Baker and Farrell employ an extremely broad definition of coordination, including both "purposive" conduct (when firms act on the expectation that rivals will punish cheating on a common understanding in order to sustain and implement that understanding) and non-purposive conduct (when firms respond to one another's price changes in a "natural and predictable" way, rather than as a part of a scheme or attempt to develop a consensus or deter price-cutting). Non-purposive conduct is not consistent with the definition of coordination

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62 Draft Merger Guidelines, paragraph 6.5.

63 The Draft Merger Guidelines, at paragraphs 6.10-11, say only that "*the CMA will analyse the extent to which the… three conditions are met*".

64 Baker and Farrell, *Oligopoly Coordination, Economic Analysis, and the Prophylactic Role of Horizontal Merger Enforcement* (2020). For completeness, we note that Baker and Farrell also discuss studies of explicit collusion and certain experimental studies of collusion.

in the Draft Merger Guidelines (or more generally in the context of antitrust enforcement), nor is it conduct that is presumptively harmful.[65] Baker and Farrell therefore provide no basis to fear that there is under-enforcement as regards coordinated effects.

With respect to the only other relevant paper referenced in the Draft Merger Guidelines (namely Kwoka, 2018), we can see no evidence cited in this paper regarding the frequency of coordinated outcomes or that supports a view that coordinated outcomes are common.[66] Consequently, we do not consider that this citation supports the CMA's statements.

6.2 The evidentiary standard for an SLC finding

We consider that the bar that the CMA has set for a finding of coordinated effects is unjustifiably low, particularly in the context of the above discussion.

In this regard, when discussing the evidentiary standard that will be applied when assessing coordinated effects concerns, the Draft Merger Guidelines distinguish between two scenarios for which the analysis will differ: those where the market shows evidence of coordination and those where it does not. We discuss each in turn.

(i) Markets which show evidence of pre-merger coordination

In cases where the CMA considers that the market shows evidence of coordination pre-merger, the Draft Merger Guidelines claim that a horizontal merger "*is likely to make coordination more sustainable or more effective, unless the structure and scale of the merged entity is so different from those of its predecessors that the incentive to coordinate has been removed*".[67] This approach is not justified.

Our first concern is that the Draft Merger Guidelines appear to put forward a low evidentiary standard for viewing a market to be subject to existing coordination – most notably that competitive parameters should simply be "consistent with" coordinated behaviour.[68] It is well-known that non-coordinated and coordinated outcomes may look very similar – that is, outcomes consistent with coordination are also often entirely consistent with the absence of coordination as well, yet the CMA appears to deem the existence of such outcomes sufficient to presume pre-merger coordination and, in turn, a likely SLC.[69]

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65 Draft Merger Guidelines, paragraph 6.1. Non-purposive reactions are not facilitating practices which aim to support coordination. It is standard practice for the CMA to assess the extent to which the merging parties monitor and react to the behaviour of other firms. This analysis is used to identify firms with which merging parties *compete*. The theoretical possibility that rivals might change the way they react as a result of a merger, and that this might be anticipated pre-merger by the merging parties, is not a reason to presume under-enforcement. For example, it might be that rivals anticipate that some customers of merging parties will oppose the merger and so target them more aggressively than they otherwise would have done (i.e. compete more closely) as a reaction to the merger.

66 *Ibid.*, paragraph 6.5. The section of this paper that touches on coordinated effects sets out a set of general arguments in favour of introducing structural presumptions in US merger control.

67 *Ibid.*, paragraph 6.9.

68 *Ibid.*, paragraph 6.7.

69 Five similarly sized, equally differentiated firms may have similar prices, margins and shares over time without any coordination taking place – the observed outcomes could nonetheless be deemed "consistent with" collusion on price or market share.

Further, the Guidelines suggest that "*evidence that firms are aware of their strategic interdependence*" may be deemed consistent with coordination.[70] This is, in our view, misguided. In competitive markets, firms may often monitor each other's prices and react to any price changes by rivals. They may also take into account how any decision to change prices would impact the pricing of rivals; this is a general feature of oligopolistic markets even absent any prospect of coordinated behaviour. Such expectations may dampen or intensify competition compared to the case in which firms do not consider reactions by their rivals – but this is not the appropriate test for coordination.

Unless there is evidence that firms "*act on a common understanding to limit their rivalry*" (i.e. behaviour which goes well beyond awareness that their rivals may react to their behaviour), pre-existing coordination should not be presumed to be present (even under the definition set out in the Draft Merger Guidelines). By claiming otherwise, the Draft Merger Guidelines give rise to a real risk that non-coordinated outcomes will be deemed to provide evidence of coordinated behaviour, thereby placing mergers in the category where the most stringent standards will be applied.

Our second (and related) concern is with the assumption that any horizontal merger in markets where pre-merger coordination is found to exist will be deemed *"likely to make coordination more sustainable or more effective, unless the structure and scale of the merged entity is so different from those of its predecessors that the incentive to coordinate has been removed*". The CMA has provided no basis for this presumption and, as a matter of economics, it is not clear why a merger would necessarily make coordination *more* likely than before. To the contrary, some structural changes (e.g. those that increase asymmetry of the largest firm vis-à-vis others) may make coordination *less* likely.

Further, as explained above, many markets that are not coordinated may have features which can be claimed to be "consistent" with coordination. If all of these markets are subsequently subject to the presumption that mergers will strengthen coordination "*unless the structure and scale of the merged entity is so different from those of its predecessors that the incentive to coordinate has been removed*" then the approach set out in the Draft Merger Guidelines could give rise to many incorrect decisions, where transactions are prohibited on coordinated effects grounds when the relevant markets were, in reality, non-coordinated, and not likely to become coordinated as a consequence of the merger. In that regard, we also note that the reference to the merged entity's structure and scale being "*so different*" that the incentive to coordinate is removed is not defined (i.e., how different is "*so different*"?) and is likely to afford the CMA an unjustifiably broad margin of discretion to intervene.

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[70] In Sainsbury's/Asda, the CMA noted (at paragraph 12.25) in this regard that "[t]*here is some evidence of online delivered groceries retailers recognising their mutual interdependence and, in particular, Tesco being advised that the economic implications of a strategy to raise delivery prices were highly dependent on competitor responses*". Although the CMA did not reach the view that pre-merger coordination was *likely to* exist in this case, this evidence was deemed *consistent with* pre-merger coordination.

The CMA should therefore reconsider both the standard required to identify pre-existing coordination and its structural presumption against horizontal mergers in markets where there is evidence that is consistent with pre-merger coordination.

Recommendation 16: The Merger Guidelines should set a higher evidentiary standard to determine whether or not a market is subject to pre-merger coordination (particularly given that such a finding would play a significant role in the CMA's assessment of whether the merger is likely to give rise to an SLC). It is not sufficient to point to pre-merger outcomes that are merely "consistent with" coordination (and thus also consistent with competition).

Recommendation 17: Where there is a valid finding of pre-merger coordination, the CMA should explain how (as opposed to assume that) the merger would strengthen pre-existing coordination.

(ii) Markets which do not show evidence of pre-merger coordination

In markets where the CMA does not find evidence of pre-existing coordination, the Draft Merger Guidelines state that it will go on to consider "*to what extent the merger may make future coordination more likely*".[71]

At the outset we note that the CMA's substantive legal test means that it must assess if anti-competitive outcomes are *likely* to arise as a result of a merger (or, equivalently, whether they are expected to occur with a probability of 50% or higher) and not simply whether they are "*more likely"* to arise.[72] As noted above, an increase in likelihood from 15% to 20% would imply "more likely", but not likely. The Draft Merger Guidelines should therefore be amended to acknowledge this.

Furthermore, the list of factors that the Draft Merger Guidelines suggest may be taken into account when assessing if a merger is likely to substantially increase the likelihood of coordination is neither satisfactory nor sufficient.

The Draft Merger Guidelines assert that a reduction in the number of competitors may increase the prospect of coordination. However, there is no reason to expect that a simple reduction in the number of firms will alter an originally competitive market sufficiently to cause a fundamental shift from a non-coordinated equilibrium to a coordinated equilibrium. That will ultimately depend on whether the impediments in the market that prevented coordinated outcomes being realised pre-merger will be removed due to the loss of one competitor. The Merger Guidelines should acknowledge that a coherent coordinated effects theory in a market with no evidence of pre-existing coordination would need to explain why the effect of the merger is sufficient to overcome those factors that guard against coordination pre-merger.

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[71] Draft Merger Guidelines, paragraph 6.9.

[72] Or, to put this another way, a merger which increases the chances of coordinated outcomes from 15% to 20% would not in our view meet the CMA's legal test for intervention.

Mergers may in fact reduce the prospect of coordination even when they reduce the number of competitors by, for example, increasing the asymmetry between market participants. The Merger Guidelines should acknowledge this and other relevant considerations which may result in coordinated effects concerns being dismissed in the list of relevant factors that will be taken into account.

Where the CMA has considered coordinated effects concerns recently – notably in *Sainsbury's/Asda* – it has pointed to specific features of those cases which it argued materially increased the prospects of coordination (e.g. the removal of a competitor that took a notably different approach to pricing which would have made pre-merger coordination hard to achieve and sustain). It did not rely on a mere reduction in the number of competitors. The Merger Guidelines should acknowledge that analysis must go beyond a simple consideration of competitor numbers in its assessment in accordance with the CMA's decisional practice.

The Merger Guidelines should also acknowledge explicitly that buyer power can disrupt coordinated outcomes, alongside the other factors listed in paragraph 6.21 of the Draft Merger Guidelines.

Finally, we note that the Draft Merger Guidelines state that *"the merger does not need to strengthen all of* [the three necessary conditions for coordination] *in order to lead to an SLC. If some or all conditions are met pre-merger then the merger may need to have only a limited impact in order to enable or strengthen coordination*".[73]

This statement is unclear (and potentially incorrect from an economic perspective) in two ways.

First, all three economic conditions (i.e. ability to reach a coordinated outcome, internal stability and external stability) must be met for coordination to be a credible (let alone a likely) outcome. That these criteria must be met cumulatively is important and appears to have been lost in the articulation of the CMA's assessment of whether a merger is likely to give rise to coordinated effects. This cumulative requirement should therefore be re-stated.

Second, for a merger to be likely to give rise to coordinated outcomes in a market not characterised by pre-merger coordination, its effect must clearly be sufficient to cause all conditions that are not met pre-merger to be met post-merger. We do not therefore think that it is correct to state that a merger that has a "limited" impact would be likely to give rise to coordinated outcomes. The Draft Merger Guidelines should therefore be updated to reflect this important point.

Recommendation 18: The Merger Guidelines should make clear that in order to establish that the mode of competition is likely to switch from non-coordinated to coordinated behaviour, the CMA will need to demonstrate not only that the three cumulative criteria for coordination are likely to be met post-merger but also that the impact of the merger is likely to be sufficiently large to trigger such a switch.

[73] Draft Merger Guidelines, paragraph 6.24.

7 Non-horizontal mergers

The current CC & OFT Merger Assessment Guidelines state: "*Non-horizontal mergers do not involve a direct loss of competition between firms in the same market, and it is a well-established principle that most are benign and do not raise competition concerns. Nevertheless, some can weaken competition and may result in an SLC*".[74] It is notable that no such statement is made in the Draft Merger Guidelines, despite the principle being "well-established" that vertical and conglomerate mergers typically do not raise competition concerns.

In the discussion of vertical and conglomerate effects, the Draft Merger Guidelines instead only note that *"[n]on-horizontal mergers may also result in efficiencies, such as reduced prices or better product integration"*.[75] The Draft Merger Guidelines then refer forward to the general efficiencies section for a discussion of how these effects may be taken into account. There, as we discuss in Section 8.1 below, the CMA provides a strong indication that it is unlikely to engage seriously on the topic of pro-competitive effects.

This material change in emphasis seems to be motivated, at least in part, by the CMA's recent focus on digital markets where it has been argued that under-enforcement exists, even in relation to non-horizontal mergers.[76] This reflects a common theme in the Draft Merger Guidelines, namely that perceived under-enforcement in digital markets has led the CMA to advocate a different approach with respect to all types of mergers, whatever the industry concerned, and whether that is justified or not (as discussed above).

Recommendation 19: The Merger Guidelines should reinstate the standard economic view that that most non-horizontal mergers are benign, can lead to efficiencies, and do not raise competition concerns.

8 Countervailing factors

The Draft Merger Guidelines discuss two types of standard countervailing factors that can prevent or mitigate any SLC arising from a merger; namely efficiencies and entry and expansion. As we discuss below, we are concerned that the Draft Merger Guidelines do not provide a balanced view of these issues, particularly in relation to digital markets.

8.1 Efficiencies and customer benefits

The framework for the assessment of efficiencies set out in paragraphs 8.8-8.17 of the Draft Merger Guidelines is generally in line with prior guidance in this area, and is, in our view, broadly fit for purpose. We are more concerned, however, with the CMA's indication that, as

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74 CC & OFT Merger Assessment Guidelines, paragraph 5.6.1, emphasis added.
75 Draft Merger Guidelines, paragraph 7.5.
76 *Ibid.*, paragraph 7.6.

a general principle, it is sceptical of the efficiency benefits of mergers, which suggests that it is unlikely to engage seriously on the topic of pro-competitive effects.

There is, currently, a "vicious circle" in relation to the assessment of efficiencies, whereby the perception that the CMA is extremely sceptical of efficiencies arguments leads the merging parties rarely to *submit* evidence on efficiencies. As a consequence, the CMA rarely *considers* efficiencies arguments. The CMA's statement that "*it is rare for a merger to be cleared on the basis of countervailing factors*" is therefore unsurprising.[77] However, a more open approach in the Draft Merger Guidelines could change this. Such a change would be particularly welcome because, in the context of the forward-looking assessment that merger analysis represents, an overly asymmetric approach to the potential harms and benefits of a transaction must inevitably increase the risk of prohibition of transactions that could lead to significant customer benefits.

The degree of scepticism that is applied to efficiencies is, on the available evidence, not warranted.

First, the body of empirical evidence available on this subject is generally limited, and clearly insufficient to adopt a prior in one direction or the other.[78] In the absence of stronger evidence, we encourage the CMA to adopt an open-minded approach and consider initiatives to improve the evidentiary base on these important issues.

Second, in terms of the evidence that *is* available, this does not justify a general presumption that mergers are unlikely to generate positive benefits for consumers.

Some evidence on whether mergers benefit customers is summarised in the two articles by Professor John Kwoka cited above (namely, a policy article of 2019 which is referenced in the Draft Merger Guidelines and a meta-survey of studies of non-price outcomes of mergers published in 2018). In both papers, Kwoka seeks to draw on the available evidence with a particular view to assessing whether the proposition that <u>most</u> mergers improve non-price outcomes for consumers holds.[79] Kwoka's key conclusion is that they do not, noting in particular that "*when the results of these studies are aggregated, it becomes harder to defend the conclusion that on balance most mergers improve non-price outcomes*".[80] However, critically, Kwoka goes on to note that "*the variation in the findings is quite large*", and that "*the implication of this variation is that, despite the average effect, policy cannot be too confident that nonprice effects might not be important in particular cases*".[81] Indeed, the results of his

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77 Draft Merger Guidelines, paragraph 8.1.

78 For example, Kwoka (2018) notes that: "*The merger retrospective literature examining nonprice effects is considerably sparser than with respect to price. The reasons for this, as suggested above, include the dearth of data and the difficulties of measuring outcomes such as "innovation" or "technological progressiveness." In addition, some outcomes such as the number of product variants may have ambiguous efficiency implications, so that even successful measurement does not answer the real question. These impediments have limited the number of studies in the literature examining nonprice outcomes*".

79 Kwoka includes in his definition of "non-price" factors all effects that do not directly affect prices. This means that cost efficiencies and other factors which could ultimately lead to an effect on prices are considered as non-price factors. Notably, since mergers may have positive and negative effects on non-price factors, both positive and negative merger effects are reported by Kwoka.

80 Kwoka (2018).

81 *Ibid.*

meta-survey indicate that 10 out of a sample of 26 studies of non-price effects showed that mergers gave rise to net positive consumer outcomes as a result of efficiencies.[82] To put this another way, whilst it is indeed hard to claim that "*most mergers improve nonprice outcomes"*, it is also hard to ignore the evidence that a significant number do give rise to benefits. All of this militates in favour of a careful, case-by-case analysis of efficiencies, and not a blanket approach which in effect amounts to a presumption that efficiencies are unlikely to arise.

In addition to these meta-survey results, Kwoka's 2019 policy review also places emphasis on a McKinsey study comparing the actual cost synergies achieved by merging parties against pre-merger claims.[83] Kwoka specifically reports the conclusion that "*most buyers routinely overvalue the synergies to be had from acquisitions*".[84] Significantly, however, whilst the survey finds that synergies may be overvalued by acquiring firms, it also finds that most mergers sampled *did* nevertheless achieve a significant share of the estimated efficiencies. Indeed, the McKinsey study shows that 93% of mergers achieve at least 75% of the cost savings estimated by management and that 39% of mergers achieve more than 100% of estimated cost savings. Therefore, this evidence again suggests that a significant number of mergers do give rise to efficiencies which should not be ignored in the substantive assessment.[85] It certainly does not support the CMA's general scepticism regarding efficiency arguments.

Finally, noting the significant debate that has arisen as regards under-enforcement in tech mergers, we observe that the available evidence suggests that it is even more important to assess efficiency considerations in these cases. In particular:

- The only ex-post analysis of merger decisions commissioned by the CMA in recent years, the Lear Report, concluded that several of the mergers in question were likely to have generated significant synergies and customer benefits. For example, in relation to Facebook/Instagram, the Lear Report states that "*Instagram's growth has significantly benefitted from the integration with Facebook: […] Instagram's success […] has likely benefitted from Facebook's guidance and expertise*," and "*the merger has also generated significant efficiencies to the benefit of users and advertisers*".[86] Similarly, the Google/Waze merger "*has enabled Google and Waze to exploit their complementarities and generate efficiencies. These efficiencies are clearly merger-specific*".[87]
- The Furman Report observes that mergers can be beneficial for consumers through: *"lower prices and new innovative products or services being made available … innovations*

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[82] *Ibid.*

[83] Kwoka's 2019 review also highlights three other sources of information on merger efficiencies. These studies are incorporated in the meta-study described above, so we do not discuss them again.

[84] We note that this study is from 2004. We do not seek to portray this as a definitive view of efficiencies but discuss it as it is the first piece of evidence cited by Kwoka in his policy review. We note that this study focusses on whether estimated efficiencies are realised. Whilst this is relevant when assessing the proportion of pre-merger efficiency estimates that may be realised in practice, this type of evidence cannot be used as a basis for claiming that mergers do not give rise to significant efficiencies. If a firm estimates £1bn of efficiencies but in fact realises £500m, that is still a significant amount that should be reflected in an analysis of the merger.

[85] Indeed, one potential explanation for the fact that synergies were overvalued by the buyer is that the degree of cost passthrough of the efficiencies gained, and hence the customer benefit of efficiencies, was greater than anticipated by the Parties to the transaction.

[86] Lear Report, paragraph II.83 and executive summary section II.2.

[87] *Ibid.*, executive summary section II.3.2.

may be brought to market more quickly and effectively … [and] products being brought successfully to a mass market that would otherwise have failed or achieved only a niche market position".[88] It notes that when large digital companies are acquiring smaller companies, "*the large majority of these cases will be either benign or beneficial for consumers*".[89] The Draft Merger Guidelines acknowledge that "[m]*any markets exhibit economies of scale… For example, many digital and software markets as well as other markets such as pharmaceutical markets*".[90] If that is the case, then it follows that there may be efficiencies generated through the realisation of economies of scale that the CMA should consider in its assessment.

Overall, we consider that the CMA should reconsider the scepticism it applies to efficiencies arguments in merger cases. This is important in general, and particularly in digital markets, where the arguments in favour of efficiencies are even stronger.

Recommendation 20: The Merger Guidelines should acknowledge that the evidence supports the view that a significant number of mergers will deliver efficiencies and commit to assessing these thoroughly on a case-by-case basis.

8.2 Entry and expansion

In relation to entry and expansion, we have noted above that the Draft Merger Guidelines indicate that the CMA intends to place significantly more emphasis on theories of harm associated with dynamic considerations such as the entry or expansion of one merging party into the other party's market. This makes sense in a world where the CMA anticipates assessing more mergers in markets that are more fluid in nature and where the prospect of a loss of potential competition is therefore more real.

However, if the CMA intends that dynamic considerations will become more relevant in its assessments, we would emphasise that a balanced approach to merger control would also place more significance on the assessment of the constraints from potential entry and expansion by third parties. A natural way of doing this would be for the CMA to commit to applying the same framework (and the same evidentiary standard) when assessing the scope for entry and expansion from third parties as it would when assessing potential competition theories of harm.

Against this background, as we have discussed above, we are concerned that the standard of proof set out for the treatment of evidence on the entry and expansion of rivals may differ from the framework that the CMA sets out for considering potential competition theories of harm. In particular, the Draft Merger Guidelines reaffirm that for entry and expansion arguments to be successful, such entry and expansion must be timely, likely and sufficient to avert an SLC. We appreciate that this is a standard framework for assessing entry and expansion arguments.

[88] Furman Report, paragraph 3.38.
[89] *Ibid.*, paragraph 3.106.
[90] Draft Merger Guidelines, paragraph 8.38d and footnote 135.

However, *if* the CMA intends to apply this framework to entry when analysing potential competition theories of harm, then this has the potential to give rise to perverse outcomes.

For example, consider a case where a potential entrant is one of four firms with a 30% chance of successfully entering a market. Do we consider the 30% prospect of entry by the target as sufficient to meet the "not-fanciful lessening of competition" test? And is the potential entry by the three other rivals to be discounted because their individual prospects of entry are not "likely"? We hope not, as this would provide a biased view of the competitive effects of the merger. We consider that the Merger Guidelines should confirm a commitment to a balanced treatment of new entry and expansion.

Finally, the Draft Merger Guidelines express some doubt about predicted entry actually occurring, based on an ex-post review commissioned by the CMA from KPMG.[91] However, the KPMG review found that "[i]*n most cases, the predictions made by the CMA / OFT in the Phase I cases we reviewed were largely realised – or where they were not, alternative sources of entry/ expansion seem to have constrained the merger parties*"[92] and "[t]*he CMA / OFT appears to have correctly predicted specific examples of entry/ expansion from closely related markets*".[93] The main cases where the KPMG report expressed concerns about the outcome had non-standard features: *Cineworld/City Screen* (a market requiring specialist premises) and *Zipcar/Streetcar* (a nascent market with significant uncertainty, where several firms did enter but largely unsuccessfully). In both cases, local policy or regulation was also cited as an important factor.[94] This suggests that the CMA should be less pessimistic about the prospects for entry in markets with characteristics conducive to entry.

Recommendation 21: The Merger Guidelines should confirm a commitment to applying a consistent standard when assessing potential competition concerns and the constraint from entry and expansion.

8.3 Buyer power

The Draft Merger Guidelines pay very little attention to buyer power, relegating it essentially to one paragraph, with sponsored entry and self-supply given short shrift in section 8 (paragraphs 8.41-8.43). The main suggestion is that an SLC can be thought of as a reduction of customer buyer power: "*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*

[91] Draft Merger Guidelines, paragraph 8.26: "*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. Therefore, evidence in relation to entry and expansion should be considered in this context*".

[92] *Entry and expansion in UK merger cases: An ex-post evaluation by KPMG* (2017), paragraph 9.

[93] *Ibid.*, paragraph 21.

[94] *Ibid.*, paragraph 10.5.1.

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".[95]

Our concerns are as follows. First, while it is correct that buyer power typically requires choice (e.g. a credible threat to switch to an alternative source of supply), the point is that an assessment of an SLC must take into account the extent to which buyers are likely to have strategic options post-merger. Merely stating that, if an SLC has been found, then buyer power must have been reduced does not provide guidance as to when buyer power might prevent an SLC in the first place. In some cases, for example, buyers may face a reduction in choice as a result of a merger but their ability to secure competitive outcomes even when faced with relatively few suppliers (e.g. through winner-take-all competitive tenders) may nonetheless mean that no SLC arises.

Second, the Merger Guidelines should acknowledge (as noted above) that buyer power may disrupt coordination.

Third, the Merger Guidelines should acknowledge that, in vertical and conglomerate cases, buyer power may be particularly effective in guarding against anti-competitive outcomes.

Recommendation 22: The Merger Guidelines should acknowledge explicitly that buyer power may prevent an SLC from arising as a result of horizontal mergers (both as regards unilateral and coordinated effects) and non-horizontal mergers.

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95 Draft Merger Guidelines, paragraph 4.19.