

Call for information on Phase 2 merger investigations

A submission by Frontier Economics¹

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Frontier Economics is an economic consultancy which regularly advises clients on national and European merger investigations, including a significant volume of CMA merger processes. This response sets out our views and key recommendations on some of the questions outlined in the CMA's call for information on Phase 2 merger investigations.

1 Key recommendations

1 Frontier Economics welcomes the CMA's call for information on Phase 2 merger investigations. The CMA has expressed an interest in hearing views on a number of questions, which are set out in full on the CMA's website.² In this note, we provide our views in relation to the following questions, with a specific focus on the role of economic evidence in Phase 2 merger investigations.

- Are there ways in which merging parties (and others) would be able to engage more effectively with inquiry groups in relation to the competitive assessment of a merger?
- Do the existing key opportunities to make written submissions (i.e. in response to the issues statement, annotated issues statement/working papers, provisional findings, and remedies working paper) work well? How could they be improved?
- Do the existing key opportunities for direct in-person engagement with the inquiry group (i.e. the site visit, main party hearing, and response hearing) work well? How could they be improved?
- Are there aspects of regimes in other jurisdictions that you consider might work well within the UK regime?

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² See <https://www.gov.uk/government/consultations/call-for-information-phase-2-merger-investigations/call-for-information-phase-2-merger-investigations#introduction>.

2 In our experience, the CMA has been somewhat inconsistent in the way it has engaged with economic evidence on cases, but overall appears to be placing less weight on this evidence than in the past. We are concerned that economic analysis and evidence is not prioritised during Phase 2 CMA merger reviews in the way that was historically the case (both at the CMA and at its predecessor the Competition Commission) and in the way that it still the case at the European Commission. We see this as an unhelpful development given the centrality of economics to competition law and to predicting how firms behave in different market contexts. More specifically, in some of the Phase 2 investigations we have recently been involved in:

- the CMA has not invested time in conducting its own economic analysis;
- the CMA case team has not shared its thinking about economic analysis submitted by the parties' advisors until Provisional Findings (PFs) were issued. At that stage, the CMA has at times listed reasons why these analyses could be put to one side, providing no genuine ability for the parties (or their advisors) to engage with the CMA to discuss its reasoning; and
- members of the inquiry group at times appeared disengaged on what we believed to be important economic considerations, both at the site visit and at the Main Parties Hearing.

3 The impact of the above manifests itself in different ways. For example:

- An absence of rigorous economic logic can lead to both too much time being spent on unfounded theories of harm and not enough time being devoted to genuine concerns. This can in turn increase the risk of incorrect decisions (i.e. both problematic deals being cleared and unproblematic deals being blocked).
- The merging parties often lack of clarity as to how they can best engage with the CMA. In some of the most recent Phase 2 cases we have been involved in, we have observed that the merging parties are often unclear on whether their arguments have been heard, to what extent they should repeat them, and what evidence is going to be most useful given the CMA's concerns. This lack of clarity on the case put against them can lead to considerable inefficiency for the merging parties and substantial costs. These costs could lead some businesses – especially small undertakings with limited resources – to consider abandoning the deal rather than progressing to Phase 2, even when they consider their substantive case is strong.
- A degree of frustration and a lack of trust by the merging parties on the extent to which deals will be assessed fairly. Some of our clients that have recently undergone a Phase 2 review process in the UK, for example, are of the view that the CMA did not understand their business.

- 4 In summary, in our experience, the increasing absence of economic thinking and analysis in the Phase 2 merger process is having a real impact on both the correctness of decision making and on how businesses feel when engaging with the CMA, with an overall negative impact on perceptions of the CMA.³
- 5 Given the above, we would encourage the CMA to re-think the role of economic evidence in the Phase 2 review process, bringing it more closely into line with both historical practice in the UK and the approach of the European Commission today. For example, we think the following economist-to-economist interactions could be useful:
- (a) **An economists' meeting early in Phase 2.** Such a meeting could, for example, take place shortly after the CMA publishes its Phase 2 Issues Statement. It would be an opportunity for the merging parties' economists to play back their understanding of the CMA's potential theories of harm and to share ideas about the types of evidence and economic analysis that could be useful to explore over the course of Phase 2 in light of this. This would help the parties to agree a common programme of activity with the CMA. At the same time, it would not in any way preclude the CMA from raising additional theories of harm or exploring other types of economic evidence as its thinking progresses over the course of the Phase 2 investigation. It would also impose no additional burden on the CMA staff as it would be for the parties' economists to lead the discussion and come forward with their proposed programme of activity. We consider there to be at least two benefits of such a meeting:
 - (i) it would help the CMA manage its own resource constraints by outsourcing work that can be more productively carried out by the parties' economic advisors;
 - (ii) it would help the merging parties to invest their resources in a way that will be most productive for the investigation, thereby helping manage costs overall. This is especially important for smaller businesses with limited resources, for whom Phase 2 investigations can be financially burdensome.

³ We recognise that the CMA is itself resource constrained and therefore needs to ensure that it is as efficient as possible in the way that engages with merging parties. However, any cost savings from restricting engagement need to be weighed against the risk of parties feeling that they have not had a fair hearing and appealing to the Competition Appeal Tribunal – with the additional costs that these processes create for all parties, including the CMA itself. We note that a number of Phase 2 cases reviewed by the CMA in 2022-2023 have been appealed. See <https://www.gov.uk/government/publications/phase-1-merger-enquiry-outcomes> and <https://www.catribunal.org.uk/>, accessed on 22 August 2023.

(b) **Economists' engagement post-working papers and/or at the Main Parties Hearing.**⁴ To the extent that economic evidence is particularly relevant for a case, we would encourage more engagement between the CMA's and the parties' economists after the working papers are published. This would be in addition to the parties' right of response to the working papers and to the Annotated Issues Statement.

(i) This could for example consist of a short slot at the Main Parties Hearing where the parties' economists have the opportunity to present the economic evidence. This would be a good opportunity for panel members as well as members of the case team to ask questions on this evidence.

(ii) To the extent that the evidence involves highly technical modelling, an addition or alternative would be to arrange a separate supplementary meeting between the economists on the case team and the economists advising the merging parties to discuss this evidence. This would be a further opportunity for the CMA to ask questions and interrogate the economic evidence. While legal advisors would be present at the meeting, the expectation would be that this would be a conversation between the economists, therefore adding minimal additional burden on the CMA's non-economist staff.

6 More broadly and in addition to the suggestions above, we would encourage close working relationships between the parties' and the CMA's economists and for these two groups to work together collaboratively. In our view a closer relationship would not in any way limit the CMA's independence, but would on contrary allow the CMA to reach well-informed decisions in an efficient and effective way. This is for example our experience when working on cases in other jurisdictions, most notably in Brussels where it is common practice for both the Case Team and the Chief Economists Team (CET) to engage directly with the parties' economic advisors during the Phase 2 process. In our experience, such open and constructive dialogue from the European Commission throughout the Phase 2 review process (for example, in the form of periodic State of Play meetings) alleviates some of the concerns highlighted in paragraphs 2 and 3 above.⁵

⁴ The timing of such meeting could vary, and for example an economist-to-economist meeting could be helpful before working papers are published, to the extent the economic evidence has been submitted in good time and the CMA has had enough time to consider this.

⁵ This has, for example, been our experience on *Meta/Kustomer* (2022), *LSEG/Refinitiv* (2021), *Vodafone/Liberty Global* (2019), amongst other cases.

2 Examples of constructive engagement between the economists in past CMA Phase 2 investigations

7 None of the recommendations we have suggested above would comprise an entirely new approach to engagement between the economists in Phase 2. On the contrary, Frontier has been involved in a number of CMA Phase 2 investigations where there was constructive engagement of this nature. Our recommendation is rather that these ways of working become standard features of the Phase 2 investigation process going forwards, to ensure a consistent approach.

8 Below we have outlined some examples of past CMA Phase 2 merger investigations that we consider to be good examples of constructive engagement between the CMA and the parties' economic advisors. In these cases:

- this engagement began early in Phase 2;
- this early engagement laid the foundations for a programme of economic modelling work that formed an important focus of discussions between the CMA and the merging parties in and around the Main Parties Hearing; and
- the economic evidence featured prominently in the CMA's decision.

Tesco/Booker (2017)

9 In 2017, the CMA unconditionally cleared the merger between Booker, the UK's largest wholesaler, and Tesco, the UK's largest retailer, following an in-depth investigation into the transaction. Economic analysis played a central role in the clearance decision, with constructive engagement between the economists on the CMA's Phase 2 case team, the inquiry group and Frontier, who acted as economic advisors to Tesco and Booker on the transaction.

10 Whilst Tesco and Booker were active at different levels of the grocery supply chain and therefore did not compete directly,⁶ Booker supplied third-party retailers that were present in the same local areas as Tesco stores. The CMA therefore considered whether, post-merger:

- the merged entity would have an incentive to raise prices or reduce service quality at Tesco stores in local areas where stores operated by Booker's retailer customers were present; and/or

⁶ With the exception of a limited number of horizontal overlaps between wholly-owned Budgens stores (Booker) and Tesco stores.

- the merged entity would have an incentive to deteriorate the wholesale proposition offered by Booker to its retailer customers in local areas where such stores overlapped with Tesco stores.

- 11 As the CMA set out in its Phase 2 Decision, the merging parties' advisors proposed a modified GUPPI framework to assess the incentives of the merged entity (the 'vGUPPI').⁷ During the Phase 2 process, the CMA indicated to the merging parties that it was minded to adopt this analytical framework, albeit there were a number of important decisions as to the inputs to be used when implementing this approach (for example, the merging parties' respective margins, diversion ratios, cost pass-through and the share of independent retailers' spend that was being made with Booker).
- 12 In response to the CMA's working paper on vertical effects incentives analysis – which used a range of assumptions to construct different scenarios as to the potential effects of the transaction on the merged entity's incentives – it was agreed that it would be useful to have an economists' meeting prior to the Main Parties Hearing. This meeting provided an opportunity for the merging parties' economic advisors and the CMA to discuss in some detail the most appropriate parameters to be used when implementing the vGUPPI framework. During the meeting there was constructive discussion between the respective economist teams, and an opportunity to discuss the most appropriate implementation of the framework at a level of detail that would not have been possible in other forums (such as the Main Parties Hearing).
- 13 Shortly after the economist meeting, the CMA requested that the merging parties' economic advisors deliver a short presentation to the inquiry group at the Main Parties Hearing on the vertical effects incentives analysis. This provided the merging parties' economic advisors with the opportunity to set out – directly to the inquiry group – their initial comments on the CMA's vertical effects incentives working paper. Given the centrality of this working paper to the overall competitive assessment of the transaction, the suggestion from the CMA to deliver such a presentation at the Main Parties Hearing was particularly well-received by the merging parties. We also note that this presentation did not 'eat-up' a significant amount of time during the Main Parties Hearing – meaning that there was still ample time for other themes to be explored with the merging parties.

Just Eat / Hungryhouse (2017)

- 14 In 2017, the CMA unconditionally cleared the acquisition of Hungryhouse by Just Eat (both online takeaway service providers in the UK) following a Phase 2 investigation. There were a number of economic issues that were critical in this case – in particular,

⁷ Tesco/Booker Phase 2 Final Decision, paragraphs 9.44, available at: <https://assets.publishing.service.gov.uk/media/5a3a7dd7ed915d618542b8df/tesco-booker-final-report.pdf>.

the role of indirect network effects – and the CMA went through an extensive evidence-gathering process during Phase 2 to assess these issues. This process included close engagement with the merging parties and their advisors.

- 15 Shortly after the Phase 2 Issues Statement was shared with the parties, it was agreed that there would be merit in having an economists meeting to discuss the key economic issues in the case. The meeting allowed for a constructive dialogue between the CMA and the merging parties' economic advisors in relation to both (i) the economic framework for two-sided markets appropriate in this case, and (ii) the most relevant empirical evidence.
- 16 The economic framework ultimately adopted by the CMA closely reflected much of the discussion during the meeting. In particular, due to the unusual economic factors relevant to online platforms, there was a recognition that firms with similar business models (i.e. little or no horizontal differentiation) may not be close competitors if they were vertically differentiated.
- 17 In addition to this, building on the discussion around the empirical evidence, the CMA carried out an econometric analysis to assess whether Hungryhouse acted as a competitive constraint on Just Eat, looking across different areas to determine whether the presence of more restaurants on Hungryhouse in a particular area reduced the number of orders placed on Just Eat. The CMA's study broadly followed an analysis that Frontier carried out on behalf of Just Eat, which was submitted during the Phase 1 investigation process.
- 18 The early engagement between the CMA and the merging parties on the key economic issues therefore laid important groundwork for addressing the unique features of online platforms central to the case.

Ladbrokes/Coral (2016)

- 19 In 2016, following a Phase 2 investigation, the CMA cleared the merger between Labrokes and Coral's betting and gambling businesses conditional on the divestment of a number of local betting offices. Economic analysis was central to the CMA's decision-making and, in particular, this was one of the first cases where a new screening approach to identify problematic local overlaps (termed the 'weighted share of shops' approach) was used. This approach resulted from considerable engagement between the CMA's economists and the Parties' advisors throughout Phase 2, both in relation to the nature of approach and the economic analyses needed to calibrate the model. There was considerable economic analysis produced prior to, and informing, the working papers and then subsequent to the Main Parties Hearing. This included:

- (a) detailed economic working papers, an economist meeting to discuss these working papers, and – subsequently – a follow-up working paper.
- (b) regular engagement between the CMA and the Parties’ advisors during the remedies process, including the Remedies Hearing and a number of further calls (roughly weekly in frequency in the early part of the process).