

# UK Competition and Markets Authority Has Proposed Updates to Merger Assessment Guidelines

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## Summary

Following its review of a series of global deals in the digital markets space,<sup>1</sup> the U.K.'s Competition & Markets Authority (the CMA) has launched a consultation on revised merger assessment guidelines (the draft guidelines) codifying its evolving practice in the digital sector and addressing recommendations made by the Furman report (Unlocking digital competition: Report from the Digital Competition Expert Panel) and the Lear report (Ex-post Assessment of Merger Control Decisions in Digital Markets).<sup>2</sup>

- The draft guidelines feature a new section on “loss of future competition” that focuses on recently developed theories of harm, such as “killer acquisitions” and innovation competition.
- The draft guidelines signal the CMA's growing willingness to engage in enforcement in the face of uncertainty when considering the likely effects of a merger.
- The update further emphasizes the use of internal documents and deal valuation as evidence in merger reviews to reveal anticompetitive intent or potential, particularly when other data or sources of evidence are scarce and market developments may be uncertain.
- The guidelines confirm that the CMA's analysis of the competitive effects of a merger will not be constrained by a strictly formulated market definition. The CMA will assess “strong” and “weak” competitive constraints that sit both within and outside the relevant market as defined.

The draft guidelines do not discuss the application of remedies in detail, but the CMA takes a firm approach to its assessment of merger remedies in the tech sector, which may be the subject of future guidance.

While this article is dedicated to the draft guidelines, we note that, in parallel to the consultation, the U.K. government has announced the creation of a new dedicated Digital Markets Unit (the DMU) within the CMA to introduce and enforce a new statutory code of conduct to govern large platforms. The scope of the DMU will move through consultation in early 2021 and the unit aims to begin work in April 2021.

Additionally, Member of Parliament (MP) John Penrose is due to deliver the findings of his report on competition policy by end of 2020, looking at how the U.K.'s competition regime can evolve to meet U.K. government policy aims in the post-Brexit environment.

## Emphasis on Dynamic Markets and Non-price Competition

Horizontal or vertical mergers may lead to a substantial lessening of competition (SLC).<sup>3</sup> The draft guidelines provide examples of scenarios capable of constituting an SLC, with a clear emphasis on dynamic markets, for instance where: (a) absent the merger, one of the merger firms could enter or expand the market and be expected to become a strong competitor or threaten the position of the other firm; (b) a merger threatens the level or pace of future innovation or development; or (c) the merger prevents effective competition from emerging in other markets/services, including new or nascent markets.

<sup>1</sup> Digital markets can be difficult to define, particularly given their fast-moving nature; however, as in the Furman report, the CMA considers a digital market to be one in which intensive use of digital technology is central to the business models of the firms that operate primarily within the market and where this raises challenges for competition, for example, online platform markets.

<sup>2</sup> Both reports were commissioned by the regulator and released in March and June of 2019, respectively.

<sup>3</sup> Current Guidelines, Section 4.1

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The draft guidelines also focus on platforms and non-price competition, a subject extensively covered in the Furman report.<sup>4</sup> Outlining how the CMA will consider relevant parameters of competition in its assessment of digital mergers, the draft guidelines specifically mention that competitive effects can still arise in situations where customers do not pay a monetary price for goods or services.

## How the CMA Will Weigh Evidence Will Vary With Context

The CMA increasingly interrogates internal documents and closely scrutinizes deal valuation evidence relating to digital markets. The draft guidelines confirm this approach, and the CMA is clear that “uncertainty will not in itself lead the CMA to conclude that competition concerns are unlikely to arise” and that it has a “wide margin of appreciation” in its use of evidence.

The draft guidelines state that the CMA’s analysis will depend on the specific facts surrounding a case and the quality of such evidence. The authority will typically attribute greater evidentiary weight to documents generated prior to the period in which the merger was contemplated. Further, the CMA will not normally consider evidence in isolation, and the weight attached to different evidence (both quantitative or qualitative) may evolve with decisional practice. The CMA may also take into account evidence of explicit intention on the part of the merging firms to take a particular course of action that would be consistent with an SLC, but the guidance does not require a “smoking gun” to identify an SLC, and the CMA may often rely on an assessment of firms’ economic incentives.

Therefore, presenting internal documents that include robust indications of pro-competitive intent and potential, and making sure the materials identified represent a comprehensive picture of the competitive implications of a transaction, will be increasingly important for companies and their advisers.

Additionally, the draft guidelines point to the CMA’s use of market definition. Noting the utility of developing certain types of evidence that are potentially relevant for the competitive assessment, the draft guidelines make clear that the CMA is not confined in its assessment to the precise boundaries of any particular market definition.

<sup>4</sup> Box 3.A at paragraph 3.74 of the Furman report.

## The Counterfactual Is Set To Play a Bigger Role in the CMA’s Analytical Approach to Merger Review

In reviewing mergers, the CMA must determine at the beginning of each case analysis the appropriate framework for the relevant market landscape: either the premerger “status quo” of prevailing competition, or an alternative counterfactual (for example, that one of the merging parties was bound to exit the market absent the transaction). The draft guidelines propose to accept more uncertainty in forming the counterfactual. In particular:

- The draft guidelines clarify that complexity and uncertainty alone do not mean that the CMA will assume the premerger situation to be the appropriate frame of analysis.
- In digital markets, the time horizon that the CMA considers when describing the counterfactual could take account of future developments beyond the typical two-year frame the CMA currently applies. The authority specifically highlighted in a recent report that “when considering entry by a merger firm, becoming successful can take longer than two years in digital markets.”

The draft guidelines describe the two different standards of proof that the CMA maintains when assessing the counterfactual to the merger. In Phase 1 investigations, the CMA may identify multiple possible counterfactuals that meet the Phase 1 “realistic prospect” standard, and then must choose the most extreme counterfactual (where the merging parties exert the most important competitive constraint on each other and third parties exert the weakest constraint). At Phase 2 of an investigation, the CMA must select the most likely counterfactual.

In dynamic markets, the potential counterfactuals will tend to be more varied, and merging parties and their advisers should anticipate the need for a strong set of pro-competitive factors.

## Enhanced Treatment of Multisided Platform Markets

Increased prevalence of digital technologies, and online platforms in particular, has led the CMA to assess an increased number of mergers in “two-sided” or sometimes “multisided” markets.

The draft guidelines suggest that the appropriate analytical approach in such cases will depend on how competition works (including whether competition is focussed on one or both sides of the platform), competitive conditions (such as the number and strength of alternatives available on each side of the platform) and network effects (including the incentive to compete on one or both sides of the platform).

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The draft guidelines state that two-sided platform mergers are more likely to induce a “tipping” effect where the winning platform can tip the market to its favor, and additionally that platform mergers are more likely to have a strong effect on incentives, as the “losing” platform may lose sales and profits as its offering becomes less attractive and customers abandon the service to adopt a new one.

## Potential Competition and Innovation — Killer Acquisitions

The draft guidelines bring an increased focus on potential competition. Per the Furman report, “the key concern here is that the removal of an important future competitor could harm innovation — if the acquired company is not developed to its full potential and if the acquiring company is not incentivized to innovate in response.”<sup>5</sup>

The draft guidelines describe two ways in which the elimination of potential competition can manifest and how it is likely to be assessed: (a) where a merger involves a potential entrant into a market that results in a loss of the future competition between the merger firms after the potential entrant would have entered or expanded the relevant market; and (b) where existing and potential competitors interact in an ongoing dynamic competitive process and a merger could lead to a loss of this dynamic competition.

The draft guidelines note that the decision to pursue a merger may supplant the creation of detailed business plans assessing alternative routes to enter or expand the market. In this context,

<sup>5</sup> Paragraph 3.81 of the Furman report.

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the CMA considers the merging firms’ abilities and incentives to enter to enter the market. In line with recent case practice, evidence relevant to the CMA’s assessment of the loss of future competition arising from a merger might include internal documents, business forecasts or valuation models.

The draft guidelines also note that while there may be some uncertainty about the outcome of investments and innovation efforts absent a merger, uncertainty about the outcome of a dynamic competitive process does not preclude the CMA from assessing the impact of the merger on that dynamic process. Accordingly, while the CMA’s assessment of dynamic competition may, in some cases, focus on entry and expansion of the market in relation to specific products, in others, its assessment may consider a broader pattern of dynamic competition in which the specific overlaps may not be identified easily.

## Next Steps and Implications

The consultation on the proposed updates will run through January 8, 2021. After the consultation, the CMA will decide whether to adopt the changes proposed in the draft guidelines and whether any further changes are necessary.

Ultimately, the proposals do not mark a significant change from the increasingly interventionist approach that the CMA has taken over the past few years. Agency experience from recent CMA cases is referenced throughout the guidance, and the proposed policy updates document the incremental shifts experienced by merging parties and practitioners over the last two years, while also reflecting the influence of research collected in the Furman and Lear reports on maintaining healthy markets.