Revised Merger Assessment Guidelines Codify UK Interventionist Approach to Dynamic Markets

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Summary

The U.K.'s Competition & Markets Authority (CMA) has released new merger assessment guidelines that confirm the U.K. regulator's intensified approach to merger control.[1] The guidelines largely codify the CMA's recent output, which includes record high numbers of prohibitions and deal abandonments.

- The guidelines downplay the importance of traditional market definition concepts in favour of assessing strong and weak competitive constraints on the merging parties. This focus is consistent with CMA's practice of considering the parties' position within broader frames of reference.
- The section on assessing loss of future competition sets out the CMA's interventionist intent in dynamic markets and in addressing so-called killer acquisitions (which involve acquiring an allegedly nascent rival) and reverse killer acquisitions (which involve buying a target whose market the acquirer would have entered absent the acquisition).
- The CMA confirms its willingness to reach conclusions despite uncertainty about how competitive conditions will develop. The agency maintains this position despite the natural tension between reaching conclusions in the face of substantial uncertainty and discharging the CMA's burden of proof on the balance of probabilities.
- The guidance reaffirms that internal documents and valuations may be treated as key evidence. This is consistent with the CMA's practice in seeking to assess competitive harms, in some cases over long time horizons, based on internal documents. It confirms that documents such as build-buy-partner analyses or internal product development discussions will be mined for indications that, absent the transaction, the buyer would have entered the market.

The guidelines take a more interventionist stance than do peer authorities, particularly in dynamic markets. And the CMA has recently challenged global transactions, even when they were cleared without issues in other jurisdictions. Therefore, companies contemplating deals potentially within the CMA's jurisdiction will need to take account of these guidelines.

The CMA's guidelines may also be influential in shaping merger enforcement beyond the U.K. They come at a time when authorities globally are rethinking their approach to acquisitions, particularly in the technology sector, based on academic commentary and reports that cite this area as the subject of perceived underenforcement in the past. In the EU, the European Commission (EC) in March 2021 paved the way for investigations of acquisitions of nascent competitors, which mergers would otherwise not qualify for review under existing national and EU thresholds, by releasing new guidelines encouraging the use by member states of a referral mechanism under Article 22 of EU Merger Regulation.[2] Additionally, the EC's proposed Digital Markets Act contemplates obligations for designated "gatekeepers" to report acquisitions, regardless of size.

[1] See our December 3, 2020, client alert "UK Competition and Markets Authority Has Proposed Updates to Merger Assessment" on the CMA's consultation on the draft merger assessment guidelines.

[2] See our April 8, 2021, client alert "New EU Guidance Creates Legal Uncertainty for Merger Control and a *De Facto* 'Killer Acquisition' Review Power" on the new Article 22 EU Merger Regulation Guidance.

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Tech Sector Implications

The new guidelines, which reflect recommendations made by the Furman[3] and Lear[4] reports on competition in digital markets, are significant for the tech sector.

First, the CMA will consider a long time horizon in assessing potential outcomes when deciding on the appropriate counterfactual, *i.e.*, the competitive conditions that would prevail absent the transaction. This follows the Lear report's finding that "even in fast-moving digital markets, becoming successful can take longer than two years." The counterfactual assessment has proven decisive in recent cases.

Also, the guidance covers deal valuation evidence, which reflects current practice. The CMA increasingly examines the evidence of deal valuation to identify whether the valuation suggests anticompetitive intent. Requested evidence includes the financial models and assumptions underpinning a deal value, to assess whether these include any projections about post-merger pricing, capacity or other effects that could raise concerns. This is particularly relevant in the tech sector, where the CMA has repeatedly tested theories of harm involving "killer acquisitions" and "reverse killer acquisitions." The CMA may find that outsized valuations suggest strategic reasons to acquire a rival based on reducing future competition.

Finally, the CMA sets out its analytical approach to two-sided or multisided platforms. The CMA may assess the two sides separately, or incorporate both sides in one assessment, depending on how competition works in the relevant industries, the competitive conditions on each side and the strength of indirect network effects. For example, where competition between platform operators involves improving aspects of one side of the platform, then the CMA may assess each side separately, *e.g.*, where two digital advertising platforms merge, considering the impact on publishers separately from the impact on advertisers. Conversely, when platforms exhibit strong indirect network effects, and competition on one side is influenced by conditions on the other side of the platform, a single assessment including both sides may be more appropriate (¶4.24 of the guidelines).

Potential and Dynamic Competition

The new guidelines set out how the CMA will assess potential and dynamic competition.

To determine loss of potential competition, the CMA will assess whether either merging firm would have entered the market or expanded absent the merger, and if so, whether the loss of future competition would bring about a substantial lessening of competition (SLC). This assessment will be similar to the scenario where the firms are existing competitors, but will reflect the competitive conditions expected to prevail in the future following market entry. To assess this, the CMA will take into account internal documents, business forecasts and valuation models, and even consider "the likely characteristics of the potential entrant's future product or service." The guidelines recognise this may involve uncertainty and assumptions.

The CMA will also assess whether a merger will reduce dynamic competition between merging firms by reducing an existing supplier's current efforts to protect against the impact of future market entry or by reducing the incentives of a dynamic competitor to innovate because it will no longer have an incentive to "steal" profits which will now be captured by the merged firm.

The CMA states that it will not be deterred by the uncertain outcome of investments and innovation efforts which frequently do not reach the market. The CMA will consider the economic value of the likelihood that new innovations or products could reach the market — even where entry is "unlikely and may ultimately be unsuccessful" (¶5.23 of the guidelines). When specific product overlaps are not easily identifiable, the CMA may consider the broader pattern of dynamic competition. Examples provided in the guidelines include: (i) merging digital platforms exhibiting a pattern of using their existing platforms or suites of integrated services as a launchpad to enter into new, overlapping services; (ii) merging pharmaceutical companies engaging in research programmes that are likely to treat the same illnesses; and (iii) merging firms with geographic expansion strategies that are likely to target similar local areas (¶5.21). In *Pure Gym/The Gym*, the CMA found that in the absence of one of the merging firms, the other may not have the same incentive to maintain certain policies, and incentives to expand geographically would likely also be materially altered.

Local Competition

Also, the new guidelines reflect recent practice on retail mergers, which typically involve some assessment of both local and national competition.

To define geographic markets, the CMA will continue to examine geographic areas when assessing mergers involving a large number of local geographic markets — for example, mergers of grocery retailers operating in multiple localities.

[3] Unlocking Digital Competition: Report of the Digital Competition Expert Panel, March 13, 2019.

[4] *Ex Post* Assessment of Merger Control Decisions in Digital Markets, May 9, 2019.

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In mergers where parties compete in many local areas, the CMA will consider how companies adjust parameters of competition depending on conditions in each local area. For example, the CMA will consider how firms set different prices or offer a different range or quality of products in different locations. If the CMA finds that parties engage in such local flexing of the parameters of competition, it may look at competition on a narrower local level (¶4.30 of the guidelines).

On the other hand, where parameters of competition are set consistently across the U.K., the CMA's analysis will focus on the various local areas in the aggregate level as the incentives of a firm to improve prices or other aspects of its competitive offer (which will depend on the aggregate conditions of competition across the geographic areas in which its stores are active). The CMA will also consider whether a merger could change the merging firms' incentives to set their competitive offering uniformly across different local areas (¶¶4.27-4.31 of the guidelines).

The new guidelines also formalize the CMA's practice of employing a filtering approach in cases involving a large number of local overlapping outlets between the merging firms. This generally involves identifying some areas as requiring no further consideration based on systematic information that is relatively easy to gather, *e.g.*, the number of stores operated by effective competitors within a certain drive time of the merging firms' stores. This allows the CMA to eliminate overlaps that will clearly not lead to an SLC from further consideration and to investigate a more manageable number of areas that fail the filter test (¶4.32 of the guidelines).

The competitive assessment of local areas that fail a filter test will be based on assessment of factors that can be systematically analyzed across all local areas, rather than on an in-depth assessment of the varied indicators of competition. Following its practice in *Sainsbury's/Asda* and *Ladbroke/Coral*, the CMA may also consider employing a decision rule when a filtering approach alone is not capable of reducing the number of local areas under consideration to a sufficiently small number, allowing the CMA to review a wider range of evidence on an area-by-area basis. This involves "developing a systematic measure or set of measures that can be used to describe the impact of the merger on competition in each area, and comparing that measure or measures to a threshold above which the CMA considers the SLC test would be met" (¶¶4.33-4.34 of the guidelines). Unlike a filter, which involves further manual review of each locality, a rule presumes an SLC in each area falling within the rule. The merging parties have no opportunity to present rebuttal evidence based on the specific facts of the locality.

Market Definition and SLCs

The updated guidance provides the CMA with more flexibility in determining what constitutes an SLC.

While the CMA's prior guidance referred to the application of the hypothetical monopolist test to determine the relevant market, the guidelines no longer reference this test. The CMA allows itself the flexibility to adopt "a pragmatic approach to identifying the most significant competitive alternatives available to customers of the merger firms" (¶9.15 of the guidelines). This is consistent with its recent practice to consider a broad frame of reference, rather than specifically defining an economic market based on a hypothetical monopolist test (the products or services to which customers would switch in response to a price increase).

Similarly, the guidance offers no safe harbours or presumption as to what will, or will not, constitute an SLC. The guidance no longer refers to the typically safe levels of concentration, such as combined market shares of less than 40% for undifferentiated competitors or a reduction of retail competitors from five to four.[5] Instead, the CMA provides more limited guidance by way of nonexhaustive fact patterns that could give rise to an SLC.

Comment

The guidelines broadly codify the CMA's increasingly interventionist approach to mergers.[6] While the new merger guidelines do not signal a change in policy, they are a significant step in consolidating the CMA's post-Brexit standing as a merger control enforcer.

[5] The old guidance noted that "previous OFT [U.K. Office of Fair Trading] decisions in mergers in markets where products are undifferentiated suggest that combined market shares of less than 40 per cent will not often give the OFT cause for concern over unilateral effects" and that "previous OFT decisions in mergers involving retailers suggest that the OFT has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above)," ¶5.3.5.

[6] Based on the CMA's published statistics from January to November 2020, 30% of transactions reviewed by the CMA in Phase 1 were moved into an in-depth Phase 2 review (which may take a year or longer). Of those nine Phase 2 transactions, only two were ultimately approved; three were blocked and four others abandoned. By comparison, in the past five to 10 years, an average of around 15% of transactions were moved into Phase 2. In its most recent report in November 2020 on the state of competition in the U.K., the CMA noted that the weakening of competition "gives sufficient cause for the CMA, regulators and government to remain vigilant in protecting and promoting competition, especially as the U.K. emerges from the severe economic impact of the pandemic," indicating that the more interventionist approach is set to continue.

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Moreover, the guidance confirms the CMA's policy intention to be a pioneer in digital industries and may influence policy in other jurisdictions. The CMA is one of the first major authorities to codify its interventionist approach in guidance. The new guidelines differ significantly from the guidance that is currently followed by other European regulators including, most importantly, the EC, none of which have yet issued substantive merger guidance on questions about evolving market definitions, theories of future harm and dominance in especially dynamic markets.

More clarity on these topics is expected from a forthcoming EC notice on market definition and is in part addressed by the EC's revised guidance on Article 22 of the EU Merger Regulation, which sets out the circumstances under which the EC may call in acquisitions for review under the Article 22 referral mechanism.[7]

[7] Commission Guidance on the Application of the Referral Mechanism Set Out in Article 22 of the Merger Regulation to Certain Categories of Cases, C(2021) 1959 final, March 26, 2021.

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