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Promoting or Hindering Competition?

Observations on the CMA's Draft Merger Guidelines

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The UK's Competition and Markets Authority (CMA) is currently consulting on a wide-reaching revision of its substantive Merger Assessment Guidelines ("the Draft Merger Guidelines").[1]

Apparently motivated by concerns of historic under-enforcement, the Draft Merger Guidelines seek to enshrine the broadest possible margin of discretion to prohibit, or require remedies before approving, mergers.

This note assesses the justification for the proposals set out in the Draft Merger Guidelines. We first set out the areas where we agree with the Draft Merger Guidelines. We then go on to explain that the Draft Merger Guidelines give rise to a real risk of over-enforcement and that any such over-enforcement would likely harm consumers and competition, and, in so doing, impair the efficient functioning of the UK economy.

Areas of agreement

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

First, the CMA states that *"consumer 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."*[2] 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 anticompetitive or procompetitive.

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."*[3] We agree. Unless this fundamental objective is met, any Guidelines will be of limited value.

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 which 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 *"The 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"*.[4]

1 https://www.gov.uk/government/consultations/updates-to-the-cmas-merger-assessment-guidelines-cma129

2 Draft Merger Guidelines, paragraph 1.3.

3 *Ibid.*

4 See CMA *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.

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 business.

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 in 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 standard will normally be applied.[5] 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.[6] 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.[7,8]

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 appears to be motivated by claims of past under-enforcement by the CMA in its application of UK merger control.[9] 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.[10,11]

And even in the digital sector, the evidence of under-enforcement is considerably less clear cut than proponents of increased enforcement claim.[12] 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.[13] 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.

5 Draft Merger Guidelines, paragraphs 2.9 and 2.31.

6 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.

7 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.

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

9 Draft Merger Guidelines, paragraph 1.7.

10 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.

11 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.

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

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

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 which, according to recent government figures, still accounts for over 90% of the UK economy.[14]

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.[15]

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 by 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 in 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.[16] Indeed, the ex post assessment of transactions in the digital sphere commissioned by the CMA points to the existence of important merger specific efficiencies.[17] 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.[18]

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

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

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

16 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.

17 See the Lear Report.

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