RBB Economics

Webinar highlights: Economic Analysis and the Competition and Markets Authority's New Merger Assessment Guidelines

On 2 June 2021, RBB Economics held a webinar to discuss the new Merger Assessment Guidelines (MAGs) released by the UK Competition and Markets Authority (CMA).[1] Simon Bishop held a Q&A session with Mike Walker, which was followed by a panel discussion between Adrian Majumdar, Alexander Baker and Amelia Fletcher, moderated by Ethel Fonseca.[2]

Below are the highlights of the webinar and our reactions to some of the issues discussed. The views of Walker indicate that much tougher merger enforcement in the UK is to be expected.

Watch the full webinar here

1. See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/986475/MAGs_for_publication_2021_-.pdf

2. Simon Bishop, Adrian Majumdar and Ethel Fonseca are partners at RBB Economics. Mike Walker is Chief Economic Adviser at the CMA. Alexander Baker is Managing Director at Fingleton Associates. Amelia Fletcher CBE is a Professor of Competition Policy at Norwich Business School and Deputy Director at the Centre for Competition Policy, a Non-Executive Director of the CMA, and a member of the Enforcement Decision Panel at Ofgem. All panellists spoke in their personal capacity and their views do not necessarily represent those of the organisations with which they are affiliated.

What are the main changes?

According to Mike Walker, the most significant change has been the **treatment of uncertainty**.[3] He noted that the default position by several competition authorities in the face of uncertainty appears to have been to not intervene. This is something that has been addressed in the new MAGs, which, as he explained, are more focused on loss of potential future competition and innovation theories of harm, both of which are inherently uncertain.[4] As to how the treatment of uncertainty is implemented in practice, he emphasised the importance of assessing the incentives of the merging firms, a point which he referred to a few more times later in the discussion.[5] Indeed, he noted that *"incentives are evidence and incentives can be extremely helpful in a world in which things are uncertain"*.[6] While Walker referred to probability distribution functions for the possible outcomes and the need to *"work out where the centre of that probability distribution function is and which side of it this particular merger is"*, it was still unclear as to how uncertainty would be treated in practice. Indeed, it appears that the CMA has considerable discretion in this area.

Alexander Baker commented on the increased focus on innovation theories of harm, agreeing with Walker that *"the dynamics of competition should be what the CMA is focused on"*, in particular since there is a clear theoretical underpinning to do so. That said, he expressed *"a bit of scepticism as to whether or not the CMA currently is well configured to achieve that"*.[7] He explained that it is not always easy to understand pathways to innovation, in particular in fast-moving digital markets where the products of tomorrow could look and feel a lot different to those today, and comparing businesses that look alike today might not be the best guide to how the market develops in the future.

Walker also pointed out that the new MAGs also reflect the fact that CMA has **less faith in the potential of entry to address the anti-competitive effects of a merger**.[8] He referred to Jonathan Baker (1997) when explaining that, when assessing whether entry is going to resolve any concerns around a merger, it is not sufficient to ask whether there will be entry in response to post-merger price rises.[9] One should consider (i) whether post-merger entry in response to a price increase would push prices down to pre-merger levels, and (ii) why that entry was not happening pre-merger (i.e., why it is profitable to enter post-merger but not pre-merger).[10]

This topic was also covered in the panel discussion, as Baker observed that the *"CMA may need to be more open to the idea that entry and expansion could come from a non-obvious source"*. In this regard, he expressed concern that the new MAGs *"don't really articulate that"* and remain *"heavily focused on the interaction between merger parties"*, noting that *"The new MAGs are clearly tougher on entry – it doesn't happen, it doesn't work – and there's a narrow view on the counterfactual, which is very rooted on the merger parties"*.

Amelia Fletcher acknowledged that *"things can come out of nowhere"*, making a reference to Facebook wiping out Myspace. She emphasised, however, that *"you have got to have pretty strong evidence that something is going to come out of nowhere if it is literally out of nowhere. … Just because you are wrong ex post does not mean that you were wrong ex ante"*.[11] This is a worrying statement if applied selectively by competition authorities to downplay the threat of countervailing constraints.

In this context, Adrian Majumdar queried whether the CMA would assess on a consistent basis how the merging parties constrain each other and how third parties constrain the merging parties.[12] In particular, linking the new MAGs' increased focus on loss of potential future competition and scepticism around third-party entry, he argued that, if the CMA considers the target's entry is unlikely overall but still likely enough that there could be an SLC, then the possibility of entry by others, which could address anti-competitive concerns, should not be dismissed simply because it is also unlikely. In this regard, Majumdar explained that the point made in the Baker article to which Walker had previously referred did not apply: the article concerns a scenario in which both merging parties are already in the market and the question is whether entry could undermine post-merger price increases. Instead, in a market in which the merging parties are potential competitors in the future, the CMA would have to consider the likelihood of entry both by one of the merging parties *and* by third-party rivals.

3. See (00:02:03).
4. Walker came back to innovation concerns later in the discussion and noted that *"Dynamic benefits from innovation are what the market economy is really about and that is what competition authorities should be most focused on."* He explained that competition drives innovation and generates dynamic benefits and therefore he would be sceptical of claims that a merger which reduces short-term competition is beneficial for long-run innovation. See (00:31:09).
5. See (00:10:28).
6. Walker brought up the assessment of firms' incentives a few times, in particular when discussing internal documents. In that regard, he emphasised that revealed preferences trump stated preferences and explained that one should question the provenance of internal documents, and for what purpose they were created, when such documents are providing evidence of the firms' intentions and that evidence is inconsistent with market data and the incentives of the firms. In those instances, he noted that either the incentives of the firms have been misunderstood or the documents are just stated preferences and do not reveal the firms' true preferences. See (00:39:50).
7. See (01:09:18).
8. See (00:05:24).
9. Jonathan B. Baker, The Problem with Baker Hughes and Syufy: On the Role of Entry in Merger Analysis, 65 Antitrust L.J. 353 (Winter 1997).
10. See also (00:35:23) for further discussion on entry.
11. See (01:26:11).
12. See (01:17:27).

Walker also indicated that there is a **mild preference for some structural presumptions** in the new MAGs.[13] In this regard, Bishop noted that the new MAGs do not provide much guidance on when mergers are *not* going to be problematic and instead focus on instances when mergers might be problematic which, in his view, was a significant change from the previous guidelines and also a *"failing"* in the new MAGs.[14]

There was further discussion on this point later on, with Majumdar arguing that the MAGs *"could have said more about presumptions, could have been clearer on presumptions, and a lot clearer on where the CMA is less likely to intervene"*.[15] He referred, for example, to paragraph 4.10 of the new MAGs, which he argued suggest *"we still have '4 to 3 or worse is bad' presumption, but now expressed more cryptically than before"*.

Is this all about being able to intervene in digital mergers more easily?

Walker explained that **uncertainty in the digital space is not what is driving the wider policy expressed in the MAGs.**[16] He noted that, in the digital industry, uncertainty *"comes in spades, so if you were to stay in a world in which you think that when it is uncertain you do nothing, obviously that would trash any digital merger interventions"*. But he explained that this issue also applies to other industries more widely. Indeed, Walker referred to the treatment of uncertainty being discussed within the CMA's economist group in the context of a standard retail merger. More generally, he explained that competition authorities should be concerned not only about *"bad blocks"* (i.e., finding concerns where concerns do not exist) but should also be concerned about *"bad clearances"* (i.e., failing to identify concerns where concerns exist), which is why lack of intervention is not justified if only based on uncertainty about future market developments.

Fletcher noted that this was an area in which the new MAGs have been influenced by the Furman report, of which she was a co-author.[17] She explained that the authors of the report indeed had concerns about the *"under review"* of M&A activity of the largest digital platforms in particular, but the Furman review also raised wider concerns, identifying a number of ways in which they felt merger review was insufficient.

However, in line with earlier comments by Bishop about the danger of spill-over into non-digital sectors,[18] Majumdar pointed out that the press release accompanying the guidelines was *"all about digital markets"* and expressed concern whether *"we have a digital tail wagging a non-digital dog. We have a dial-up in enforcement that is driven by concerns about underenforcement in digital markets, but it spills over to non-digital markets yet there is no strong evidence of underenforcement in non-digital markets in the UK"*.[19]

Baker noted that *"some theories of harm that we get very exercised about in respect of digital markets, we probably should have looked at in a number of more traditional markets"*, including references to the assessment of deal valuations.[20] That said, he was worried that *"a lot of the concerns about digital markets are not really competition concerns"*, indicating that some concerns may actually refer to, for example, privacy or wider political considerations.

What role does market definition play in the CMA's merger assessment?

Walker explained that **moving the market definition chapter to the end of the new MAGs is not signalling a change of approach, but a better reflection of the CMA's view on the relevance of market definition.**[21] He stressed that this change should not be interpreted as suggesting that its role in merger assessment has been diminished or that this is the last thing the CMA will do in its investigations. When challenged by Bishop on the role of market shares and structural analysis in the absence of market definition, Walker explained that in cases where market definition is expected to be helpful, market definition and structural analysis (e.g., assessment of market shares, fascia counts) will continue to play the same role as before. That said, in cases where market definition is expected to be less useful (e.g., differentiated products cases, where structural analysis plays a limited role and the focus is on closeness of competition), instead of spending significant time and effort on market definition, which is only meant to aid the competitive assessment, Walker noted that the appropriate approach would be to focus on the competitive effects assessment. He highlighted that *"The point we want to make is we are not going to be slaves that need to define the relevant market before we actually get on to a competitive effects analysis."*

13. See (00:06:48).
14. See (00:12:44).
15. See (01:02:50).
16. See (00:07:46).
17. (2019). Unlocking digital competition, Report of the Digital Competition Expert Panel. HM Treasury.
18. See (00:07:46).
19. See (01:29:19).
20. See (01:30:49).
21. See (00:14:55).

However, it is self-evident that whenever a structural analysis, including market shares, forms part of the competitive assessment, this necessarily implies a definition of the relevant market. The question is whether the market is defined according to the accepted economic rigour of the hypothetical monopolist test or an *ad hoc* non-rigorous approach.

Economic analysis: What role for diversion ratios, margins and price pressure tests? Any lessons from the EU General Court's O2/Three judgment?

While both Walker and Fletcher considered the General Court had gone too far in O2/Three, Walker acknowledged that the General Court had been an important influence on moving the European Commission towards a more economics-based approach in the past.[22] As to how the CMA would have approached O2/Three differently from how the General Court said it should be done, Walker emphasised that the focus would be on assessing whether there was a loss of competition that would lead to consumer harm and highlighted that the merging parties *"do not have to be closest competitors, they have to be close competitors."* However, he did not spell out when close was close enough, an issue raised by the General Court.

On the issue of defining a threshold to distinguish between significant and non-significant price-effects, Walker was of the view that **competition authorities should have flexibility when relying on thresholds in order to take into account the importance of the market in question**.[23] He explained that, in particular in light of prioritisation principles, he would be more concerned about small anti-competitive effects in a large, important market (e.g., groceries) than about larger anti-competitive effects in a small, unimportant market. On the use of GUPPI analysis more generally and whether it is appropriate to rely on these figures as predictions of price increases (i.e., indicators of consumer harm) rather than first step filters, Walker commented ***"Are GUPPIs a really useful thing to use not just in Phase I as simple thresholds but [also] in Phase II? Yes, they are"***. This is again a worrying statement. GUPPIs only provide a static economic assessment. Although Walker acknowledged the need to assess whether supply-side responses would undermine the merging firms' ability to act on the pricing incentives identified by the GUPPI analysis, this is rarely undertaken in practice.[24,25] Any emphasis on GUPPIs in Phase II will significantly increase the likelihood of overenforcement.

22. See (00:18:43).

23. See (00:22:13).

24. See (00:25:05).

25. For further discussion on the wider implications of the CMA's mechanical use of GUPPI values as a decision rule, see RBB Brief 60: Sainsbury's/Asda and the CMA's GUPPI decision rule: On the money or basket case? Available at https://www.rbbecon.com/downloads/2019/10/RBB_Brief-60.pdf