

## Fuel for thought? Developments in CMA local merger assessment

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1. Completed acquisition by Bellis Acquisition Company 3 Limited of Asda Group Limited Decision on acceptance of undertakings in lieu of reference, Competition and Markets Authority, 28 June 2021.

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2. RBB advised EG throughout the Asda acquisition and merger review processes.

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3. Anticipated merger between J Sainsbury PLC and Asda Group Ltd Final report, Competition and Markets Authority, 25 April 2019.

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4. The CMA also considered the supply of LPG and convenience retailing, where the transaction impact was minimal.

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5. Retail mergers commentary, Competition and Markets Authority, 10 April 2017.

### Introduction

The UK Competition and Markets Authority (CMA) recently accepted a package of site divestments and cleared the acquisition of grocery retail chain Asda by petrol retailer Euro Garages (EG).<sup>1,2</sup> This transaction follows the CMA's prohibition of a previous attempted acquisition of Asda by Sainsbury's, a competing grocery chain.<sup>3</sup>

The EG/Asda merger investigation focused on competition between petrol filling stations (PFS), at both the local and national level.<sup>4</sup> In this Brief we review the CMA's approach to the assessment of local PFS overlaps, and discuss its implications for phase I review in future local market cases, with particular reference to the CMA's recently published Merger Assessment Guidelines (MAGs).

The key implication of the EG/Asda decision for future local market merger reviews is the CMA's approach to the use of local concentration filters. Where historically such filters have been used by the CMA to rule out areas of concern and to identify areas meriting in-depth assessment, the CMA is increasingly adopting such filters as determinative decision rules in phase I merger reviews.

We argue that this approach of placing increased weight on mechanical decision rules inherently reduces the quality of merger review, by unnecessarily ignoring relevant and available evidence that could and should inform competitive assessment. The CMA's own past record demonstrates that case by case local review of potentially problematic areas can be undertaken within the timescales of phase I merger inquiries, and so efficiency considerations cannot be a justification for moving away from proper competitive assessment.

From a practitioner's perspective, if the CMA is indeed moving towards increased reliance on mechanical decision rules in local merger review, this will move the focus of advice away from the full assessment of competition in particular local areas and towards the design and analysis of alternative concentration rules.

### Local market analysis and filtering

Local mergers have historically made up a high proportion of national competition authorities' merger assessment workload in Europe, given the Commission's jurisdiction over transactions with an EU dimension. This has been true of the UK CMA, which has established its approach to local market assessment over a period of many years. This approach was set out in the 2017 Retail Mergers Commentary and further developed in subsequent merger decisions and the MAGs.<sup>5</sup>

The competitive assessment of local markets presents practical difficulties when there is a large number of such markets potentially to be considered. Local competition may take place within very narrow catchment areas defined by consumers' travel distances, such that retail mergers may create hundreds of separate overlaps between the parties' outlets. Comprehensive individual assessment of hundreds of horizontal overlaps is not feasible within practicable timescales, and so a pragmatic approach must be applied.

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6. Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc: A report on the mergers in contemplation, Competition Commission, September 2003.

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7. Retail mergers commentary, *op cit.*, paragraph 3.2.

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8. Completed acquisition by CD&R Fund IX of MRH (GB) Limited Decision on relevant merger situation and substantial lessening of competition, Competition and Markets Authority, 5 October 2018, paragraphs 79 to 90.

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9. RBB advised MFG during this CMA merger investigation.

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10. The filters originally identified 84 local areas, but the parties opted not to contest 23, leaving 61 areas for in-depth review.

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11. Note that in the intervening Sainsbury's/Asda phase II merger investigation, the CMA undertook a GUPPI based analysis of local PFS overlaps based on ad hoc survey evidence, an approach that would not be practicable within a phase I review. The use of GUPPI analysis in the Sainsbury's/Asda decision has been questioned, including the CMA's failure to cross check its analysis against other qualitative and quantitative evidence. For further details see Sainsbury's/Asda and the CMA's GUPPI decision rule: On the money or basket case?, RBB Economics Brief 60, October 2019.

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12. Completed acquisition by Bellis Acquisition Company 3 Limited of Asda Group Limited Decision on relevant merger situation and substantial lessening of competition, Competition and Markets Authority, 21 May 2021, paragraph 97.

The CMA's approach, developed during the 2003 Safeway grocery retail merger investigation, has historically been to apply a two stage process, whereby local filters are used in the first instance to identify areas of potential concern that are then the subject of detailed competitive assessment in the second stage.<sup>6</sup> Local filters are rules defined on the basis of readily observable market features that serve as a guide to competitive conditions. Examples include local fascia or site counts, or market shares within local catchments.

While these measures cannot give a complete picture of competition within a local area, they can provide a first proxy for competitive assessment and a screen to direct the focus of merger assessment. As stated in the CMA Retail Mergers Commentary, "when there are many overlaps between the Parties' stores the CMA uses filters to screen out overlap areas where there are unlikely to be competition concerns [...] this allows the CMA to focus on the remaining overlap areas, which are each analysed in more detail".<sup>7</sup>

This approach has been applied to a number of PFS merger cases. In MFG/MRH, for instance, the CMA was faced with assessing competition between 566 overlapping PFS.<sup>8,9</sup> It applied local filters to these sites based on three competitive parameters: the parties' site-level price monitoring rules, geographic proximity, and fascia count. These filters ruled out competition concerns for the majority of the overlaps, allowing the CMA to focus its analysis on 61 local areas where concerns could not be rejected on the basis of the competition filters.<sup>10</sup>

The CMA proceeded to assess competition within each of these areas, considering a mixture of qualitative and quantitative evidence on local market features. These included distances between the parties' sites; local traffic flows; additional detail from site-level pricing rules; the number, location and identity of local competitors; and shares of supply. Based on this more comprehensive assessment the CMA was able to rule out competition concerns in 55 of the 61 local areas that failed the screening filters, leaving six areas to be resolved by site divestments.

This example illustrates the value of the CMA's filtering process for local merger assessment. From a very large initial number of overlaps, the CMA was able to use a mechanical rule to quickly screen out non-problematic cases in order to focus on areas justifying more thorough analysis. A more detailed competition analysis was undertaken for these areas, taking account of a range of quantitative and qualitative information that could not have been incorporated into an empirical screen or realistically considered for every single local overlap. This detailed assessment allowed the identification of "false positives" picked up by the conservative screening filters, leaving only those six areas in which a thorough competitive assessment suggested competition concerns did indeed arise. This filtering process allowed the CMA to focus its resources and to move from a large number of initial overlaps to a small number of competition concerns requiring divestment remedies, all within the timeframe of a phase I merger inquiry.

## The CMA's approach in EG/Asda

A similar approach to phase I review might have been expected in the analysis of local PFS overlaps in EG/Asda.<sup>11</sup> In this case however the CMA did not use local filters as a screen, but instead used those local filters as a binary decision rule. On this approach, the CMA applied competition filters as in MFG/MRH, but rather than proceeding to undertake further assessment of the areas identified by those filters, it instead regarded those areas as presumptively giving rise to a realistic prospect of an SLC without further assessment or discussion.

The CMA considered it "unnecessary and inappropriate" in EG/Asda to apply the two stage filtering process used in previous retail mergers.<sup>12</sup> This approach appears to have been driven by two key considerations: the need for efficiency within phase I review processes, and a preference for the use of easily defined mechanical decision rules over the complexities of detailed local assessment.

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13. The CMA has stated that it may apply decision rules in lieu of competitive assessment in the case of phase II mergers giving rise to very large numbers of potentially problematic areas. See Retail Mergers Commentary, *op. cit.*, paragraph 3.3.

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14. EG/Asda decision, *op. cit.*, paragraphs 156 and 179.

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15. This point was also made in Anticipated acquisition by Heineken UK Limited of Punch Taverns Holdco (A) Limited Decision on relevant merger situation and substantial lessening of competition, Competition and Markets Authority, 11 July 2017, paragraph 177; and Completed acquisition by Breedon Group plc of certain assets of Cemex Investments Limited Decision on relevant merger situation and substantial lessening of competition, Competition and Markets Authority, 9 October 2020, paragraph 176.

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16. EG/Asda decision, *op. cit.*, paragraph 87.

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17. Merger Assessment Guidelines, Competition and Markets Authority, 18 March 2021, paragraph 4.33.

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18. Retail Mergers Commentary, *op. cit.*, paragraph 3.6.

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19. Webinar highlights: Economic Analysis and the Competition and Markets Authority's New Merger Assessment Guidelines, RBB Economics, 14 July 2021, page 3. Available at <https://www.rbbecon.com/webinar-highlights-economic-analysis-and-the-competition-and-markets-authoritys-new-merger-assessment-guidelines-2/>

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20. Such an approach might have some merit in the context of national theories of harm, including that considered in EG/Asda, which are hypothesised to derive from overall scale rather than specific local market features. The CMA concluded that there was no competition concern arising from national effects in EG/Asda however.

The reference to phase I efficiency considerations appears to signal a change in approach since the 2018 MFG/MRH decision.<sup>13</sup> The scale of the local road fuel overlaps in EG/Asda was comparable to that seen in MFG/MRH, where the CMA did undertake local competitive assessments of areas identified by competition filters. In EG/Asda there were road fuel overlaps between 508 sites, fewer than the 566 seen in MFG/MRH. Similarly, application of competition filters based upon fascia count, market shares, supermarket PFS numbers and site level price rules in EG/Asda identified 36 local overlaps, materially fewer than the 61 local areas analysed in detail in the MFG/MRH decision.<sup>14</sup> Investigating these 36 local overlaps further would not have required significant information gathering by the CMA, as the parties provided extensive submissions on each of these areas, taking account of features such as traffic flows, distances between the parties' sites, and the number, location and identity of local competitors, as considered in MFG/MRH. The CMA chose not to engage with that evidence however.

The second justification for the CMA's adoption of a decision rule approach in place of a two stage approach of screening followed by local review indicates a desire to prioritise a systematic approach over ad hoc competitive assessments.

The CMA suggested that there are risks to a filtering approach, whereby certain parameters of competition are taken into account only in the assessment of local areas that fail a filter, rather than systematically across all areas of overlap.<sup>15</sup> The CMA's argument is that the results of an initial filter could be undermined if inclusion within that initial filter of additional parameters considered subsequently would have resulted in additional areas failing the filter.<sup>16</sup> This concern about the use of non-systematic local assessment is also reflected in the CMA's recently published MAGs, which state that "competitive assessment of local areas that fail a filter will typically be based on an assessment of factors that can be systematically analysed across all local areas (rather than an in-depth assessment of the varied indicators of competition)".<sup>17</sup>

This approach would seem to disregard the benefits and purpose of the local filtering process historically applied by the CMA. If those initial filters are set sufficiently conservatively then they can screen out clearly unproblematic cases while allowing the identification of areas meriting closer attention and review of the available evidence. It is notable that in MFG/MRH, 55 of the 61 areas identified for closer review were ultimately found not to be problematic; this suggests that the CMA was able to apply filters that erred heavily on the side of over-identifying potential concerns for detailed assessment. Moreover, as the CMA has noted, sensitivity analyses can be used to ensure that the initial filter does not fail to identify potentially problematic areas.<sup>18</sup>

This move to a decision rule for retail merger assessment can be considered one manifestation of a broader shift in the CMA's approach to merger control, as set out by the CMA's chief economist in a recent discussion of its updated MAGs.<sup>19</sup> Commenting on the CMA's approach to digital mergers, and referring to retail merger analyses, it was suggested that where competition authorities may traditionally have been concerned with the risk of "bad blocks" (i.e., over-intervention), they should instead put more emphasis on the risk of "bad clearances" (i.e., under-intervention). This fits with the apparent concern in EG/Asda that evidence considered in cases identified by an initial filter might, if applied within the initial filter, identify additional areas of potential concern.

Insofar as this were a concern, it could be addressed by adjustments to the initial filter, including the sensitivity tests referred to in the Retail Mergers Commentary. Certainly, any concerns about unobserved under-intervention within the initial filter cannot be addressed by generating deliberate over-intervention through disregarding available evidence on sites highlighted by that filter. There is no logic to such an approach in terms of the objectives of competition policy. If the CMA believes that its decision rule may be erroneously clearing a merger in one local area, harm to consumers in that area would not be addressed or offset by requiring unnecessary divestments in entirely separate local areas.<sup>20</sup>

As a final comment, one potential justification for the decision rule approach (though we are not aware of the CMA making this case) could be an increase in legal certainty. It could be argued that the loss of flexibility and accuracy from eschewing proper local competitive assessment may be offset to some extent by allowing merging parties to forecast the conclusions the CMA might reach. This is not the case in practice however, as the CMA is not bound by its prior decisions and generally tailors the rules in each review to the circumstances of that transaction. In EG/Asda, for instance, the parties discussed numerous potential decision rules with the CMA, with the final set of rules applied covering similar forms of evidence to those considered in MFG/MRH, but with non-trivial variations and material additional complexity surrounding the treatment of supermarket PFS. This set of rules could not have been forecast by the parties prior to notification on the basis of the available PFS merger precedent, and parties to future deals will be equally uncertain as to the precise rules the CMA might apply in its review.

The CMA's emerging approach to phase I local merger assessment therefore recognises the benefits of flexibility in merger assessment in terms of tailoring local filters to the case in question; but admits only an arbitrarily limited form of flexibility that can be expressed within mechanical binary decision rules, setting aside important probative evidence that cannot be readily incorporated into such rules.

### Concluding remarks

The recent EG/Asda decision has highlighted a potentially significant development in CMA policy for phase I assessment of local retail mergers. The CMA appears to be moving away from its traditional two stage approach of initial competition filters augmented by detailed local assessment of cases identified by those filters, and towards a binary system determined solely on the basis of mechanical rules. This appears to be motivated by a questionable objective to offset potential unobserved under-intervention in some local areas by disregarding evidence of over-intervention in others.

From a practitioner's perspective, the main implication of this change in policy will be to increase the importance of decision rule design. Where historically merging firms and their advisors could be relatively agnostic as to the filters applied, given the subsequent scope to undertake thorough competitive assessment of areas identified by filters, under a system of determinative decision rules the specification of those rules becomes crucial. It will therefore be more important for merging parties and their advisers to fully investigate ahead of notification the range of potential decision rules that the CMA might consider, the evidential basis for alternative rules, and the overall implications of those rules.