The risk of a Phase 2 reference in UK merger control: lessons and future direction

Ben Forbes & Mat Hughes
AlixPartners UK LLP

Introduction

Parties planning mergers that are subject to UK merger control typically need to understand the risk of their mergers being subject to detailed Phase 2 investigation. This is because such investigations delay full merger integration, are expensive (both in advisor fees and management time), and are risky as securing clearances is not a formality. Over the last three years, the Competition and Markets Authority's (CMA) Mergers Intelligence Unit has also reviewed more than 600 transactions each year, calling in 13–14 per year for a Phase 1 investigation. Accordingly, it cannot be assumed that one can "fly under" the UK merger control radar.

The CMA can also impose wide ranging remedies, including prohibiting the merger as it did most recently in *Sainsbury's/Asda* (2019). Accordingly, it is important that the parties and their advisors appreciate the key factors that influence the risk of a detailed Phase 2 investigation. A good place to start is therefore the CMA's recent Phase 1 decisions to understand the key themes and patterns that emerge. This is where we start this chapter. However, UK merger control is constantly evolving. Brexit is likely to lead to more mergers being considered by the CMA; the Chairman of the CMA recently indicated that the voluntary nature of UK merger control should change as regards large mergers; and the Furman Review recommended that certain designated digital companies should be required to notify their mergers in advance (as well as moving toward a 'balance of harms' approach). We therefore consider both past decisions and the potential future direction of UK merger control in the sections below.

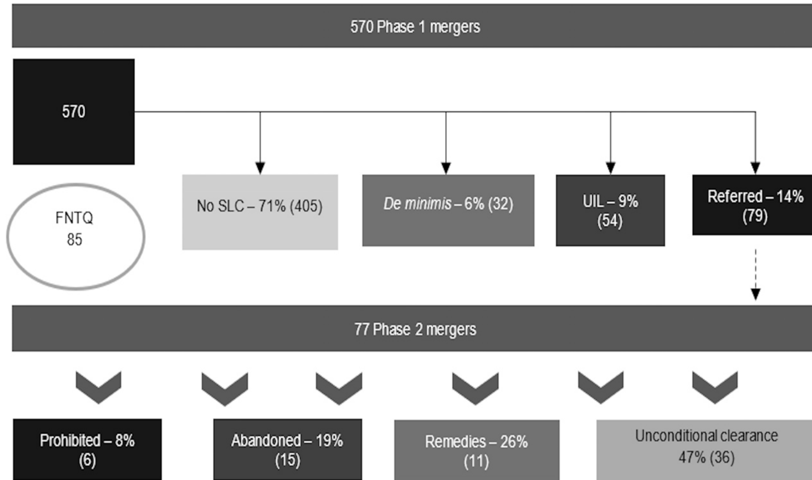
This chapter:

- sets out an overview of the outcomes of UK Phase 1 merger decisions between 1 April 2010 and 31 March 2019, and considers whether UK merger control has become more interventionist over time;
- considers why mergers were referred or cleared subject to undertakings *in lieu* of reference (UILs);
- assesses the key factors that affect the risk of a reference, and why mergers are cleared at Phase 1;
- highlights some recent developments in the CMA's decision making and interesting Substantial Lessening of Competition (SLC) findings;
- comments on the future direction of UK merger control; and
- draws some conclusions on assessing the risk of a reference.

The outcomes of Phase 1 merger decisions between 1 April 2010 and 31 March 2019

The outcomes of 570 decisions taken by the Office of Fair Trading (OFT) and CMA between 1 April 2010[1] and 31 March 2019 are summarised in the following chart.[2] The percentages and figures in brackets relate to the number/share of merger decisions of all qualifying mergers, excluding mergers that were not found to qualify for investigation.[3]

CMA Phase 1 and Phase 2 merger decision outcomes from 1 April 2010 to 31 March 2019



The chart shows that 71 per cent of Phase 1 mergers were cleared without a SLC, 6 per cent were cleared on *de minimis* grounds, 9 per cent were cleared with UILs, and 14 per cent referred. Of those referred, approximately half were cleared unconditionally, and approximately one-third cleared with remedies. A further 19 per cent were abandoned and only 8 per cent prohibited, although some mergers may have been abandoned as the parties expected remedies to be imposed that would undermine the commercial rationale for the transaction.

The CMA's merger statistics also permit us to consider how the likelihood of the OFT/CMA reaching a SLC finding at Phase 1 (including mergers cleared on *de minimis* grounds) and Phase 2 have varied over time. This is set out in the table below.

<u>SLC findings – Phase 1 and Phase 2</u>

Time period	2010/11–2013/14	2014/15–2015/16	2016/17–2018/19
% SLC findings as regards qualifying mergers at Phase 1	27% (72/266)[4]	30% (40/132)	33% (56/172)
% of SLC findings at Phase 2	31% (11/36) (19% abandoned, 7/36)	13% (2/16) (25% abandoned, 4/16)	52% (13/25) (16% abandoned, 4/25)

From this table two points are striking. First, one consequence of the UK's voluntary filing regime, compared to the compulsory filing regimes that apply in most other jurisdictions, is that it is

focused on investigating mergers that may raise competition concerns, rather than formalistically reaching decisions in relation to all mergers that satisfy turnover or asset-based merger control thresholds that apply in many other jurisdictions. In particular, the CMA reached a SLC finding in just under a third of all qualifying mergers between 1 April 2016 and 31 March 2019.[5] Accordingly, those advocating that certain mergers must automatically be notified to the CMA prior to completion, or more generally that all UK mergers be pre-notified prior to completion, should appreciate that this may make UK merger control less focused on mergers most likely to lead to a SLC.

Second, UK merger control appears to have become more interventionist over time at both Phase 1 and Phase 2. At Phase 1, the proportion of qualifying mergers where a SLC finding is reached has progressively increased over time. Whilst the overall percentage point increase over time is relatively modest, there has been a 20 per cent increase in the relative number of SLC findings. An element of this may be attributed to the CMA exercising its discretion not to open merger investigations where a merger may qualify for investigation, but where there are no material competition concerns based either on briefing papers from the parties or the parties' responses to the CMA's initial letter.[6] However, this is not likely to be the full explanation as this would require the universe of qualifying mergers chosen to be investigated by the CMA to have fallen by about 17 per cent (1/1.2) relative to the position prior to the formation of the CMA on 1 April 2014. In short, based on this statistic and our review of Phase 1 decisions, we perceive that Phase 1 UK merger control has become more interventionist over time.

Turning to Phase 2, the proportion of cases where a SLC finding has been reached at Phase 2 has also increased in the most recent period, albeit this may be affected by the small number of Phase 2 cases.

As regards the cases where a SLC finding was reached, it is striking that:

- just over half of all mergers where a SLC finding was found were cleared either:
  - unconditionally on the basis of the so-called '*de minimis*' exception, where the OFT/CMA concluded that the markets affected were not of sufficient importance to justify a detailed Phase 2 investigation.[7] This exception does not apply where there are clear-cut UIL that could be offered; or
  - conditionally subject to UILs, usually to divest part or all of the business that is the source of the competition concerns.
- the remainder were referred. However, excluding those mergers that were subsequently abandoned, 58 per cent (36 mergers) were cleared unconditionally at Phase 2 (although this has declined to 32 per cent in the last three years). Accordingly, it should not be assumed that a SLC will be found at Phase 2.

Why are mergers referred or only cleared subject to UIL?

The CMA has adopted the "Merger Assessment Guidelines", previously published in September 2010 by the OFT and Competition Commission, the CMA's predecessors. These Guidelines indicate that mergers may have a wide variety of anti-competitive effects, referred to as 'theories of harm'.

The Guidelines identify two broad categories of mergers: horizontal mergers (i.e. mergers between competitors); and non-horizontal mergers (such as where firms supply essential inputs to rivals or complementary/related products purchased by customers). Horizontal mergers can be further segmented into:

- those mergers with unilateral effects, where the loss of rivalry between the merging parties renders it profitable for the merged entity to increase its prices unilaterally or otherwise worsen its competitive offering; and
- those with "coordinated" effects, where the concerns relate to the merger facilitating competitive coordination between rivals to the detriment of customers.

The Guidelines indicate that non-horizontal mergers may enable firms to foreclose competition by, for example, denying rivals access to essential inputs or customers/distribution channels, or by leading to competitive coordination between rival firms.

In short, the Merger Assessment Guidelines describe an array of ways in which mergers may lead to a SLC. However, a rather different picture emerges considering the 133 Phase 1 mergers referred or subject to UILs between 1 April 2010 and 31 March 2019 (excluding the two water mergers subject to automatic reference). In fact, the vast bulk of SLC findings relate to horizontal unilateral effects:

- where the merger created or enhanced high market shares of 40 per cent or more. These mergers represent 52 per cent of all mergers where the OFT/CMA referred the merger or accepted UILs;[8] and
- where the merger reduced the number of rivals from four to three or fewer. These mergers make up 44 per cent of all mergers where the OFT/CMA referred the merger or accepted UILs.[9] The majority of these cases relate to mergers between local retailers, wholesalers or service providers, but the CMA has not applied fascia counts at Phase 2 in several recent retailer mergers (see, for example, *Sainsbury's/Asda* (2019)).[10]

There is only one SLC finding involving excessive buyer power (*European Metal Recycling/Metal & Waste Recycling* (2018)) and no cases involving conglomerate effects.[11]

Only two cases were referred because of pure vertical effects (namely, *BT/EE* in 2015 and *ICE/Trayport* in 2016).[12] While *BT/EE* was cleared unconditionally at Phase 2, *ICE/Trayport* was notable as the CMA's first full divestment, which is particularly noteworthy as the parties did not notify the merger.[13]

Coordinated effects cases are also very rare. Since the Enterprise Act came into force in June 2003, there are only two adverse findings based on coordinated effects at Phase 2: *Anglo American/Lafarge* (2011), and *Asda/Sainsbury's* (2019).[14]

As discussed further below, the CMA may clear a merger where there is compelling evidence that one of the parties would have exited the market in any event, such that the so-called 'exiting firm' argument applies. However, there may also be an exiting firm 'offence', where the parties decide to close related businesses around the time of the merger, and this may reduce competition. In particular, since 1 April 2010, there are three cases where the OFT/CMA's reference decision was heavily influenced by their conclusion that, in the absence of the merger, one of the parties may not have exited various markets (notwithstanding that the business activities that had ceased were not sold to the acquiring party)[15] and/or would have entered a market where the other party was active.[16]

A further point to note is the prevalence of competition concerns in local/regional markets, with 65 per cent of referred mergers and mergers where UILs were accepted relating to local/regional markets.[17] This highlights the complexity of local competition issues, particularly when the parties have networks of outlets or depots.

The factors that affect the risk of a reference – An overview of the key risk factors

A review of the 133 cases where the OFT/CMA referred a merger or accepted UILs indicates that the following factors increase the risk of a SLC finding:

- the merger creates a concentrated market structure by:
  (i) increasing the merged entity's market share by at least five percentage points to over 40 per cent; or
  (ii) reducing the number of rivals from four to three or fewer, particularly in retailing/wholesaling/service provider or bidding/negotiating markets;
- the merger affects a large number of local markets as the parties have many nearby outlets or depots. This is primarily due to the complexity of assessing a large number of overlaps;
- the merger relates to differentiated product markets, including, in exceptional cases, where the parties have a low combined market share.[18] In such cases, the CMA may be concerned that the loss of rivalry between the parties creates incentives for the merged entity to increase its prices or otherwise worsen its offer; and
- where the above conditions apply, competition concerns are increased if:
  (i) the parties have unhelpful internal documents – particularly if these identify the other party as the closest rival or the merged entity plans to increase prices post-merger; and
  (ii) customers complain – particularly where customers will have limited alternative options post-merger.

However, the OFT/CMA have still cleared mergers at Phase 1, even in concentrated markets.

One key driver of merger control clearances at Phase 1 is the OFT/CMA concluding that the parties are not close competitors, and that sufficient rivalry will remain post-merger. However, market shares and the number of rivals are not always a good measure of these matters. Assessing whether the parties are 'close competitors' or, alternatively, whether sufficient rivalry remains, depends on the nature of competition in the market in question. There are three broad categories of markets:

- differentiated markets, such as local retailing markets and branded consumer goods markets. In such markets, prior to a merger with a rival, a factor constraining the parties from increasing prices, or otherwise worsening their offer, is the proportion of sales volumes that they would consequently lose. However, following a merger, the merged undertaking's incentives may change, because some of the sales that would have previously been lost may be retained (or internalised) by the merged entity. The change in profit incentives depends on the gain in profits, in particular the gross profit margins on the proportion of lost sales (which is commonly referred to as a diversion ratio), which is internalised. This provides the intuition for the emphasis in the Guidelines on gross profit margins and the closeness of competition between the parties;
- bidding/negotiation markets, where firms compete by submitting bids to customers or negotiating with them. In bidding/negotiation markets, the CMA will also focus on whether the merged entity will face sufficient rivalry post-merger. However, in bidding/negotiation markets, the emphasis is less on the market shares of each competitor and more on whether a sufficient number of credible suppliers will remain post-merger, and the extent to which the parties win/lose bids between one another; and
- undifferentiated markets, which firms compete based on their outputs or capacities. Assessing a merger where firms are relatively undifferentiated is quite different from

mergers in differentiated markets. In undifferentiated markets, the question is simply whether customers can switch to alternative suppliers if the merged entity attempted to raise prices or worsen its competitive offer, which will depend on factors such as the costs customers will face if they switch supplier and whether rivals have sufficient spare capacity.

The relevance of competitive dynamics

Even where relatively few sizeable competitors will remain, the CMA still considers competitive dynamics. In particular, customers may not be adversely affected if barriers to entry and expansion are low, or if they will have sufficient countervailing buyer power. In addition, in a few cases, the exit of one of the parties may be inevitable if it is failing, such that a loss of competition would occur in any event. However, it is clear that compelling evidence is required at Phase 1 for these considerations to lead to a merger being cleared.

The OFT/CMA have considered arguments relating to barriers to entry and expansion in 366 of its 570 Phase 1 merger decisions between 1 April 2010 and 31 March 2019. In the vast majority of these cases (61 per cent), the OFT/CMA did not need to conclude as the merger was cleared for other reasons. In only 17 cases (5 per cent) were the arguments accepted. A detailed review of these 17 cases suggests that entry/expansion arguments may play a supporting role in clearance decisions, but there are some examples where particularly compelling evidence on entry/expansion has been key to the OFT/CMA's Phase 1 clearance decisions.[19]

In 176 cases, the OFT/CMA considered the extent of countervailing buyer power, but in 57 per cent of cases, there was no need to conclude as the merger was cleared for other reasons. However, where the OFT/CMA did conclude, in only 12 cases (7 per cent) were arguments as to customers' buyer power accepted.[20] Interestingly, there have been no acceptances of countervailing buyer power as a decisive factor to clear a merger since *Flogas/Macgas* in early 2013, potentially reflecting greater caution on the CMA's part at Phase 1 as to the ability of powerful customers to safeguard their interests if they have few alternative suppliers. In this regard, it is also important to bear in mind that mergers may reduce customers' buyer power by reducing the number of suppliers to whom they can threaten to switch, and not all customers may have sufficient buyer power.

The final element of competitive dynamics is whether the exiting firm argument applies, which depends on the imminent exit of one of parties' businesses, the absence of alternative purchasers for the business or assets in question, and a consideration of competitive conditions following any such exit. The OFT/CMA has considered this issue in 73 cases between 1 April 2010 and 31 March 2019. However, the exiting firm argument has been accepted in only seven cases (10 per cent of the cases where these arguments are advanced).[21] These few cases confirm the OFT/CMA's stated position of cautiously assessing the merger against the prevailing conditions of competition if any real doubt or uncertainty remains as to whether the exiting firm argument applies.

Recent developments and interesting SLC findings

Since we published the Third Edition of Parr, Finbow and Hughes (2016),[22] there have been a further 50 SLC cases (i.e. in the three years to 31 March 2019). This section considers some recent developments in the CMA's decision making and interesting SLC cases during that time.

CMA recognising online as a competitive constraint in certain cases

Although not a SLC case, *JD Sports/Go Outdoors* (2017) was the first Phase 1 merger where

the CMA accepted online competition as a local competitive constraint in a retailing merger.[23] This was due to strong evidence of online competitive constraints, including survey evidence showing substantial diversion to online-only players, and in-store price matching of online competitors.[24] The CMA also accepted online content was a constraint for some magazines in *Future/Miura* (2016), particularly where the content was similar in nature.[25] However, the CMA still found a SLC in certain magazine types as survey evidence showed that online competition would not provide a sufficiently strong constraint to counteract the negative effects of the merger.

CMA still sceptical of exiting firm arguments

In *Capita/Vodafone* (2017), the parties argued that Vodafone was planning to exit the pager business in the near future. This was despite positive cashflow, and mainly due to the end-of-life technology that would require upgrading to continue competing, a declining subscriber base, and a change in strategy for Vodafone toward next generation products.[26] However, the CMA was more swayed by evidence suggesting the merger was partially the reason for its accelerated demise, thus they were not convinced the business would have closed absent the merger (i.e. failing limb one of the exiting firm test).[27] As a result, the merger was referred to a Phase 2 investigation. However, on reference, Vodafone, frustrated with facing a lengthy Phase 2 investigation, decided to abandon the acquisition and close the pager business.[28]

In *Euro Car Parts/Andrew Page* (2017), the parties argued that as Andrew Page was in administration, the appropriate counterfactual was Andrew Page inevitably exiting the market. While the CMA was satisfied that this was the case (accepting limb one), they were not satisfied that there were no less anti-competitive purchasers (both for key accounts and the 52 bid sites at the local level),[29] nor were they convinced the sales would have diverted to Euro Car Parts in any event.[30] While the merger was referred to Phase 2, the parties eventually got some respite as the CMA partly accepted the exiting firm argument at Phase 2 (for 49 depots, the head office and national distribution centre).[31]

Market share evidence – exceptions to the rule

In the section above, we noted that as a general rule, market shares above 40 per cent (and increments above 5 per cent) were likely to result in a SLC. However, this is not always the case and there continue to be exceptions.

In *Tullett Prebon/ICAP* (2016), the CMA did not reach an adverse finding despite high shares in voice/hybrid broking (in 11 markets it was above 40 per cent).[32] This was because the CMA did not believe market shares were indicative of market power, mainly due to potential for expansion by other brokers, out-of-market constraints, influence of large customers, limited customer concerns, and falling broker commission.[33]

Conversely, in *Menzies/Airline Services* (2018), the parties had a combined market share of 20–30 per cent in ground handling with their largest competitor, DHL, having a 60–70 per cent share via one contract with EasyJet.[34] However, some airlines expressed concerns that there was a lack of alternatives to the parties, particularly for smaller airlines. Two other rivals were much smaller and targeting certain aircraft, and some suggested that DHL were capacity constrained, hampering their ability to compete effectively for further contracts. As a result, the merger was referred to Phase 2. However, it was cleared unconditionally at Phase 2 as, depending on the specific airport/services considered, the CMA found either limited actual rivalry between parties, sufficient rivalry from alternatives, and/or low barriers to entry.

There are also cases that are more finely balanced. In *Electro Rent/Microlease* (2017), the parties submitted that they would have a combined share of supply of 40–50 per cent (5 per cent increment).[35] However, the CMA found that the parties overestimated the market size and thus actual combined shares would likely be higher. To pour further cold water on the merger, customers said that the parties were close competitors and they were "often" the only credible suppliers. The Phase 2 decision also highlighted that parties were the only rental partners of some large OEMs giving them greater discounts and a cost advantage, and rivals were relatively differentiated or had a narrow focus. The only remedy that the CMA was satisfied with was for Electro Rent to sell its UK arm.[36]

One of the most significant decisions in the last few years is *Sainsbury's/Asda* (2019).[37] A key issue in *Sainsbury's/Asda* was the methodology that the CMA applied to identify local and national competition concerns, with the CMA's prohibition decision largely driven by its use of the Gross Upward Pricing Pressure Index (GUPPI) to identify local and national SLC findings across grocery and petrol retailing.

We commented in a personal capacity on the CMA's use of GUPPI in response to its Provisional Findings.[38] In short, GUPPI measures the merging parties' incentive to increase prices (or worsen their quality range or service) through estimating three variables, namely diversion ratios, gross margins, and relative price levels.[39] However, this raises two important questions: what GUPPI threshold should be set so that a SLC can reasonably be expected; and how much reliance should be placed on GUPPI given the uncertainties in measuring the three variables identified and efficiencies?

The CMA's answer to these questions is that it should exercise case-specific judgment, arriving at its view that a GUPPI threshold of 1.5 per cent was sufficient for a SLC for supermarket and fuel overlaps – before allowing for proven efficiencies.[40] However, in our view this is an unprecedented low threshold, and one that suggests almost all mergers between competitors would be problematic absent proven efficiencies. For example, if only 10 per cent of the business lost by one party pre-merger were to be won by the other (i.e. diversion ratios are only 10 per cent, such the 90 per cent of the business lost is won by other rivals or customers buying less) and gross margins are 25 per cent, then this would suggest a GUPPI of 2.5 per cent and thus a local SLC.[41]

The CMA increased the thresholds for GUPPI above 1.5 per cent for groceries because it accepted that there were offsetting merger specific efficiencies (albeit that these were smaller than those estimated by the parties), which reduced the effect on incentives to increase prices by 1.25 percentage points. It also increased the GUPPI threshold by half a percentage point for convenience stores to reflect uncertainties in measuring GUPPI as regards convenience stores. It is also striking that the CMA wholly relied on GUPPI without considering actual competitive conditions in the affected local markets.

This case suggests that the CMA will reach an adverse finding – in groceries and fuel markets at least – even if many local competitors remain. Small-scale groceries and fuel transactions are also much less likely to generate substantial efficiencies, and thus will be treated more harshly.

New in fashion?

The last three years saw a resurgence in SLC decisions across a wider range of cases. One case that is worthy of note is *European Metal Recycling/Metal & Waste Recycling* (2017). It is the first adverse finding involving anti-competitive buyer power at Phase 1 since before 1 April 2010.[42] In that case, the CMA was concerned that the absence of purchasing competition could mean businesses, local authorities and individuals might be paid less for

the waste scrap metal, and that the parties were particularly close competitors for industrial contracts.[43]

However, the CMA did not reach an adverse finding as regards excessive buyer power in either *Tesco/Booker* (2017) or *Sainsbury's/Asda* (2019). *Sainsbury's/Asda* is particularly noteworthy as this was a merger between two of the largest national groceries chains and there is an entire regime set up to address the adverse effects associated with excessive buyer power in the groceries sector, including a specialist regulator (the Groceries Adjudicator). However, the CMA did not reach an adverse finding as regards buyer power, even though the CMA included merger efficiencies associated with lower purchase prices in assessing the competitive effects of the merger.[44]

Innovation has been a hot topic in the last few years, particularly with the European Commission finding that mergers may harm global innovation (see, for example, the European Commission's decision in *Dow/DuPont* (2017)[45] and *Bayer/Monsato* (2018)). It is thus not surprising that the CMA is paying closer attention to whether mergers may adversely affect innovation. In particular, in *Experian/Clearscore* (2018), the CMA was concerned with a loss of innovation at the consumer level given Clearscore's track record of innovation and clear intention to continue to develop new and innovative credit checking tools.[46] Additionally in *Tobbi AB/Smartbox and Sensory Software* (2019), the CMA noted harm from reduced innovation and product termination, resulting in less choice for customers and end users.[47]

In keeping with the CMA's interest on forward-looking assessments of potential future competitive harm, there have been two recent SLCs at Phase 1 concerning a loss of potential competition. In *PayPal/iZettle* (2019), the CMA investigated whether there would be a loss of actual potential competition for the supply of omni-channel payment services to small, micro and nano merchants. At Phase 1, the CMA found that iZettle's likelihood of entry or expansion into the market for omni-channel was high as they had already taken steps toward entering, with this entry or expansion likely enhancing competition and making iZettle an important competitive constraint in the absence of the merger.[48] However, at Phase 2 the CMA provisionally cleared the merger despite its view that, in the absence of the merger, PayPal would have become a stronger competitor as regards mobile point of sales services. This provisional clearance decision was due to the material constraint applied by point-of-sale providers for both PayPal's existing customers and competition for new customers, and the significant constraint from Square and SumUp in relation to nano merchants.[49] Similar potential competition concerns in the filter supply market were identified at Phase 2 in *Thermo Fisher Scientific/Roper Technologies* (2018), although detail on the reasons why are redacted from the public Provisional Findings.[50]

While competition authorities typically require divestments to address the competitive concerns raised by mergers (including vertical mergers[51]), price controls have been accepted in particular circumstances, most notably in rail franchise mergers where the competition issues are limited to certain overlapping flows on certain routes. An example of this is the *FirstGroup/MTR South Western Rail Franchise* (2017) merger where the parties agreed to restrict fare increases on the London to Exeter route to the corresponding weighted average unregulated fare increase for travel on the Franchise Comparator Flows.[52]

Finally, customer benefits helped to clear the *Central Manchester University Hospitals/University Hospital of South Manchester* (2017) merger. After the case was fast tracked to Phase 2, the CMA found adverse effects in NHS elective and maternity services and NHS specialised services in Greater Manchester. However, the only practical and effective remedy to the SLC was prohibition of the merger. Therefore, the CMA had to

carefully consider whether this remedy was proportional given the nature of the SLC and the size of the 11 'relevant customer benefits' (RCBs) that the CMA found. Interestingly the CMA concluded: "*Taking the above factors in the round, we consider that the adverse effect likely to result from the SLC in NHS elective and maternity services and NHS specialised services is, in the particular circumstances of this case, substantially lower than the beneficial impact of the RCBs that would be lost as a result of prohibition. In our judgement this is not a finely balanced conclusion. Accordingly, we have decided to clear the merger.*"[53]

A change in direction for UK merger control?

As advisors there have been several recent developments that have given us pause for thought about the future direction of UK merger control and whether the past is a good guide to the future.

UK merger control continues to be largely voluntary, in the narrow sense that the merging parties are not obliged to notify the CMA prior to completion (or at all). However, since 2015/16, the CMA's Mergers Intelligence Unit have reviewed more than 600 transactions each year, with 13–14 of these on average being subject to Phase 1 review.[54] Accordingly, it should not be assumed that unnotified mergers will go unnoticed by the CMA. Moreover, over the last three years, these unnotified transactions accounted for 23 per cent[55] of the mergers that were considered at a CRM (i.e. the transactions that potentially warrant a detailed Phase 2 investigation). In 10 of these 19 cases (i.e. just over half) the CMA found there was a realistic prospect of a SLC, resulting in seven Phase 2 investigations.[56]

The CMA can also impose initial enforcement orders prohibiting merger integration and requiring the parties' businesses to be held separately.[57] Unsurprisingly it expects strict compliance with these orders, evident by the string of fines in 2018/19 for breaches of interim measures. This includes: a £100,000 penalty on Electro Rent in June 2018; a further £200,000 penalty on Electro Rent in February 2019; and a penalty of £300,000 on European Metal Recycling in December 2018.

Moreover, the UK merger landscape continues to evolve in a number of ways.

First, following Brexit it seems likely that more mergers affecting the UK will fall for consideration by the CMA. This is because the European Commission will no longer have exclusive jurisdiction to consider the UK aspects of large mergers that currently fall under EU Merger Regulation.[58]

Second, the voluntary nature of the UK regime may also change, with the Chairman of the CMA advocating that certain large mergers be subject to compulsory pre-completion review by the CMA. This is to ensure that UK merger investigations can be coordinated with compulsory filings to the European Commission and other competition authorities.[59]

Third, the Furman Review recommends that certain designated digital companies should be required to notify their mergers in advance, and that these mergers should be reviewed at Phase 2 on the basis of a "balance of harms" standard, rather than whether a SLC "may be expected".[60]

Finally, reflecting its increasing reliance on internal documents for merger assessments, in January 2019 the CMA published guidance on requests for internal documents in both Phase 1 and 2 merger cases.[61] In November 2017, the CMA imposed a penalty of £20,000 on Hungryhouse for failing to provide documents that were responsive to Section 109 Notices, which came to the CMA's attention later in the investigation. These points highlight that proper – and potentially large scale – document review has become an essential prerequisite for advising on UK merger control risks.

Conclusions

The focus of this chapter has been on the key question of what really matters in UK merger control. Experience suggests that UK merger control is predominantly focused on mergers between competitors where the core concern is whether the loss of rivalry between the parties would render it profitable for the merged entity to increase prices or otherwise worsen its offer. This is not to say that other competition concerns cannot arise, for example, adverse effects on innovation. However, in practice, they do so infrequently.

However, there are a number of indications that UK merger control is becoming more interventionist. This can be observed both in terms of overall trends at Phase 1 and Phase 2, but also specific cases, perhaps most specifically following the CMA's approach in *Sainsbury's/Asda*.

Finally, while a deep knowledge of past decisions in invaluable in assessing the risk of a reference, advisors must also monitor ongoing developments to understand where past practice may not be a good guide to the future.

Acknowledgment

The authors would like to acknowledge the contribution of their economist colleague Rameet Sangha for her helpful comments on this chapter.

* * *

Endnotes

1. The start date of 1 April 2010 was chosen as it approximately corresponds with when the OFT and Competition Commission were finalising their joint Merger Assessment Guidelines, with the final version being published on 16 September 2010.
2. This excludes two mergers between water and sewerage enterprises that are subject to automatic reference and 85 decisions where the transaction was found not to qualify for investigation. See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/557408/merger-inquiry-outcomes-to-30-september-16.pdf. The Phase 2 outcomes often do not match the Phase 1 referred cases as the Phase 2 decision may be reached in the calendar year after the Phase 1 decision.
3. The reason for excluding mergers that were found not to qualify for investigation is simply to make the statistics more comparable and to focus the comparisons on the OFT's and CMA's decisions as regards qualifying mergers. It should be noted that the number of merger decisions that a merger does not qualify for investigation each year has collapsed from 12–23 per year between 2010/11 to 2013/14, to 10 in 2014/15 (the first year following the CMA's formation), to 0–2 cases per year from then onwards. This is due to the CMA's requirement that mergers filings are submitted in draft and it assesses whether filings are complete (i.e. mergers must be pre-notified), which reduces the number of non-qualifying mergers that are notified. Pre-notification lasted on average 33 working days in 2018/19. See the CMA's merger update to the Law Society, titled: "UK Merger Control: 2018 in review and a forward look at 2019", slide 11. Available at: https://events.lawsociety.org.uk/uploads/files/93d5ce9f-cf7e-4b21-9230-5512a65e9111.pdf.

4. As noted above, this excludes two water mergers subject to automatic reference.
5. A high proportion of qualifying mergers are considered at a Case Review Meeting, which assesses whether the merger potentially warrants detailed Phase 2 investigation. The number of qualifying mergers considered at a CRM are: 83/213 from 2010/11 to 2012/13 (39%), 67/185 from 2013/14 to 2015/16 (36%), and 83/172 from 2016/17 to 2019 (48%).
6. See "Guidance on the CMA's mergers intelligence function", CM56, 5 September 2017. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/648247/CMA56.pdf.
7. Notably, the OFT/CMA have applied the *de minimis* exception in 19 per cent of SLC cases over the whole period. The CMA increased the market size thresholds at which this exception may be applied from £3–10m to £5–15m in June 2017, but this does not appear to be translating into materially more mergers qualifying for the *de minimis* exception – with only 7 mergers cleared on *de minimis* grounds over the last three years. (Below the lower end of these ranges the CMA indicates that it will generally not consider a reference justified, but above the higher end of the range a reference would generally be justified. In between these ranges, the CMA will weigh up the expected customer harm against the cost of a reference).
8. 69/133 cases. In some of these cases, additional SLCs were also found relating to the loss of potential competition (four cases), vertical effects (nine cases) and coordinated and vertical effects (one case).
9. 59/133 cases.
10. In some of these cases, competition concerns were identified on the basis of the merged entity's local market share rather than the number of competitors.
11. A noteworthy case in relation to conglomerate effects is *Information Resources Inc./Aztec* (2014). The CMA's first clearance decision was successfully appealed to the Competition Appeal Tribunal, but the CMA cleared the merger again at Phase 1.
12. *Tesco/Booker* (2017) was predominantly referred due to vertical competition concerns, with this merger being cleared unconditionally at Phase 2.
13. AlixPartners acted for EE in relation to the *BT/EE* merger.
14. A SLC based on coordinated effects was only found for online groceries in those local areas not serviced by Ocado. See *Sainsbury's/Asda*, Phase 2 Final Report, paragraph 81.
15. In Stena/DFDS, OFT decision of 8 February 2011 (paras 164–167) and *Ratcliff Palfinger/Ross & Bonnyman Limited*, OFT decision of 18 February 2011 (paras 106–112), one of the merging parties rationalised its operations such that it exited certain markets and only sold part of its businesses to the purchaser. At Phase 1 in each of these cases, the OFT's SLC finding was based on the counterfactual evidence that these exits would not otherwise have occurred in the absence of the merger.
16. In *Linergy/Ulster Farm* (2016), at Phase 2, the CMA concluded that, despite a memorandum of understanding signed in 2012 setting out the parties' intention to merge, the parties would have taken the same decision to close one plant and not to open another. Therefore, under both the counterfactual situation and the actual situation at the time of the merger, the parties did not operate competing rendering plants. The CMA therefore concluded at Phase 2 that the merger did not result in any horizontal overlaps between the parties (see further paras 5–18).
17. 79/135 cases.

18. For example, in its Phase 1 decision in *A.G.Barr/Britvic* (2013), the OFT found a SLC notwithstanding that the merged business had a combined market share of 10–20 per cent in the supply of carbonated soft drinks to the "off-trade" (i.e. sales via retailers for consumption at home). This merger was cleared unconditionally at Phase 2.
19. See, for example, *Ballyclare/LHD* (2014), *Web Reservations International/ Hostelbookers.com* (2013), or *Tulip/Easey* (2017). (AlixPartners acted for the parties on *Ballyclare/LHD* (2014).)
20. See, for example, *Unifeeder/Feederlink* (2012).
21. See, for example, *Sports Direct/JJB Sport* (2012) or *Aer Lingus/City Jet* (2018).
22. UK Merger Control: Law and Practice, Third Edition, Sweet & Maxwell, 30 November 2016. This book was written by a team of authors at Ashurst LLP and AlixPartners UK LLP. The AlixPartners authors are Ben Forbes, Mat Hughes and Rameet Sangha.
23. For a detailed analysis of the case and the CMA's new retailer merger commentary see: "*Substantial local complexity? The CMA's revised retail mergers commentary and its application in three recent cases*", Competition Law Journal, October 2017.
24. *JD Sports/Go Outdoors*, paragraphs 87 and 109. AlixPartners acted for the parties in relation to this merger.
25. *Future/Miura* (2016), paragraph 6.
26. *Capita/Vodafone* paging (2016), paragraph 29.
27. *Capita/Vodafone* paging (2016), paragraph 30.
28. https://www.theguardian.com/business/2017/may/10/vodafone-axes-pager-service-mobile-technology.
29. *Euro Car Parts/Andrew Page* (2017), paragraphs 94 and 100.
30. *Euro Car Parts/Andrew Page* (2017), paragraph 110.
31. *Euro Car Parts/Andrew Page* (2017), Phase 2 Final Report, paragraph 6.38.
32. *Tullett Prebon/ICAP* (2016), paragraph 135.
33. *Tullett Prebon/ICAP* (2016), paragraph 10.
34. *Menzies/Airline Services* (2018), paragraphs 129 & 130.
35. *Electro Rent/Microlease* (2017), paragraph 39.
36. https://www.gov.uk/government/news/cma-requires-electro-rent-to-sell-its-uk-arm.
37. This merger was prohibited on 25 April 2019, and thus falls after the period covered by the merger statistics analysed earlier in this chapter.
38. "*Submission to the Competition and Markets Authority in Sainsbury's/Asda - The appropriate application of GUPPI*", Ben Forbes, Mat Hughes, and Rameet Sangha, 13 March 2019. Available at: https://assets.publishing.service.gov.uk/media/5c926af9ed915d07aab51544/Alix_Partners_response_to_PFs.pdf.
39. The intuition behind GUPPI is that, pre-merger, it is not profitable for either of the merging parties to increase their prices unilaterally (or worsen their quality, range or service (QRS)). This is because the foregone profits on sales they would lose, outweigh the extra profits on sales they retain. These sales would be either lost to competitors or from consumers simply buying less. However, following a merger with a competitor, the sales that would have been lost to the merging rival are now internalised by the merged group.

40. The CMA admitted that there was more uncertainty as regards convenience stores, and thus it set a pre-efficiencies threshold of 2.0 per cent for these stores.
41. Assuming that the relative prices of the parties' stores are the same.
42. The last adverse finding at Phase 2 involving anti-competitive buyer power was *Stonegate/Deans* (2007).
43. For a detailed analysis of anti-competitive buyer power in UK and EC merger control, see: "*Anti-competitive buyer power under UK and EC merger control – too much of a good thing?*", Burak Darbaz, Ben Forbes, and Mat Hughes, Global Legal Insights Merger Control guide, 2018.
44. For further discussion of the CMA's use of GUPPI in this merger, see: "*Submission to the Competition and Markets Authority in Sainsbury's/Asda: The appropriate application of GUPPI*", Ben Forbes, Mat Hughes, and Rameet Sangha. Available at: https://assets.publishing.service.gov.uk/media/5c926af9ed915d07aab51544/Alix_Partners_response_to_PFs.pdf.
45. For a detailed analysis of this case, see: "*Understanding the New Frontier for Merger Control and Innovation – The European Commission's Decision in Dow/DuPont*", Ben Forbes, Mat Hughes, and Rameet Sangha, The International Comparative Legal Guide to: Merger Control 2018.
46. *Experian/Creditscore*, paragraph 151. The case was abandoned after the CMA's provisional adverse finding at Phase 2.
47. *Tobbi AB/Smartbox and Sensory Software* (2019), paragraph 132.
48. *PayPal/iZettle* (2019), paragraph 13. Notably this merger has been provisionally cleared at Phase 2 at the time of writing.
49. PayPal/iZettle (2019), Phase 2 Provisional Findings, paragraph 41.
50. *Thermo Fisher Scientific/Roper Technologies* (2018), paragraph 14.2.
51. See for example, *ICE/Trayport* (2016).
52. *FirstGroup and MTR Southwestern franchise* (2017), proposed undertakings with appendices, paragraph 3.2.
53. *Central Manchester University Hospitals/University Hospital of South Manchester* (2017), Final Report, paragraphs 53 and 54.
54. These statistics are based on a presentation given by Colin Raftery, Senior Director of Mergers at the CMA, entitled "UK Merger Control: 2018 in review and a forward look at 2019", which was given at the Law Society on 12 March 2019.
55. 19 mergers and 81 CRM meetings.
56. Of the remaining three cases, two were cleared on *de minimis* grounds (i.e. the CMA exercising its discretion that the markets affected by the merger are not of sufficient importance to warrant detailed investigation), and one was presumably cleared on the basis of undertakings *in lieu* of reference (although the latter point is not expressly indicated in the CMA's table, see the presentation referenced at Note 54).
57. See "Guidance on initial enforcement orders and derogations in merger investigations", CMA60 (5 September 2017).
58. This may be covered by some transitional arrangements if these are agreed. A good summary of the possibilities is set out by Ashurst on its website in its Competition Newsletter of 11 April 2019 entitled: "No deal, transitional arrangements and a potential future deal: Brexit's practical implication on competition law".

59. See "Letter from Andrew Tyrie to the Secretary of State for Business, Energy and Industrial Strategy", 21 February 2019. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/781151/Letter_from_Andrew_Tyrie_to_the_Secretary_of_State_BEIS.pdf.
60. The Furman Review is a report for the Chancellor of the Exchequer and Secretary of State for Business, Energy and Industrial Strategy on unlocking competition in the digital age. The specific recommendation on mergers focused on ensuring UK merger control can be forward looking, with the CMA empowered to take more frequent and firmer action to challenge mergers that harm consumer welfare. It can be accessed here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf. Colleagues from AlixPartners comment on this report in the following article: "Unlocking digital competition…but locking up innovation". Available at: https://emarketing.alixpartners.com/rs/emsimages/2019/Pubs/FAS/AP_Unlocking_Digital_Competition_Apr_2019.pdf.
61. This covers what the CMA considers a responsive document, its use of mandatory requests, and the detailed procedure under which they should be produced. The guidance is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/773103/guidance_on_internal_documents_in_merger_investigations.pdf.

Ben Forbes
Tel: +44 20 7098 7457 / Email: bforbes@alixpartners.com
Ben is a Senior Vice President in AlixPartners' European competition practice, which is part of a broader litigation practice.
He has over 10 years of experience as an economist advising on a range of competition and regulatory matters. He has particular experience in relation to market investigations and mergers, including acting for HSBC in relation to both the CMA and FCA investigations into retail banking and in advising on various mergers (including a recent retailer merger cleared unconditionally at Phase 1: JD Sports/Go Outdoors). He has written extensively on the economics of merger control including co-authoring two chapters in the Third Edition of UK Merger Control: Law and Practice, November 2016. He also works more generally on competition and litigation matters, including, in particular, relating to financial services and telecoms markets.

Mat Hughes
Tel: +44 20 7098 7420 / Email: mhughes@alixpartners.com
Mat Hughes is a Managing Director in AlixPartners' European competition practice, which is part of a broader litigation practice. He has over 29 years of experience as an antitrust economist and in dealing with competition authorities, courts and specialist utility regulators in relation to all aspects of competition law. Mat has advised on more than 30 Phase 2 merger and market investigations and a very large number of Phase 1 mergers, as well as more generally on a range of competition and litigation matters. Mat started his career as an economist at the UK Office of Fair Trading, and until March 2013 was Chief Economist at Ashurst LLP. Mat has written widely on the economics of merger control, including the third edition of "*UK Merger Control: Law and Practice*", 2016.

AlixPartners UK LLP

6 New Street Square, London, EC4A 3BF, United Kingdom
Tel: +44 20 7098 7420 / URL:www.alixpartners.com