Merger Control
2020

Consulting editor
Thomas Janssens

LEXOLOGY
Getting The Deal Through

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4147
Fax: +44 20 7229 6910

First published 1996
Twenty-fourth edition
ISBN 978-1-83862-149-0

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

Merger Control
2020

Consulting editor
Thomas Janssens
Freshfields Bruckhaus Deringer

Lexology Getting The Deal Through is delighted to publish the twenty-fourth edition of *Merger Control*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the consulting editor, Thomas Janssens of Freshfields Bruckhaus Deringer, for his and the firm's continued assistance with this volume.

LEXOLOGY
Getting The Deal Through

London
July 2019

How and when economic submissions help decision makers in merger control proceedings

Peter Davis and Kostis Hatzitaskos[1]

Cornerstone Research

Introduction

Economic analysis is central to assessing whether a merger will result in a significant lessening of competition (SLC) in the US and UK or a significant impediment to effective competition (SIEC) in the EU. While the jurisdictions' legal tests may use different terminology, the substantive assessment of a proposed merger is similar across jurisdictions.

In contrast, the decision-making framework for merger control differs markedly across jurisdictions. In the EU and UK, the merger control system is regulatory, with competition agencies making legally binding decisions about whether a merger would result in an SIEC or SLC, respectively. Although merger appeals are rare, particularly in the EU, the agencies' decisions are subject to judicial oversight (by the General Court (and ultimately the European Court of Justice) in the EU, and by the Competition Appeal Tribunal in the UK, and ultimately the UK's Court of Appeal and UK Supreme Court). In the US, the Federal Trade Commission (FTC) and Department of Justice (DOJ) must go to court to persuade a judge to enjoin a merger.

The key challenge in all jurisdictions is to develop economic evidence that will be persuasive to the relevant decision makers. No matter the jurisdiction, the key test of economic evidence is whether it helps them fulfil their obligations as decision makers. Both agencies and courts find economic evidence useful when it:

- is understandable to decision makers;
- answers or informs the answers to relevant questions; and
- is found to be worthy of evidential weight after detailed examination.

In this article, we briefly discuss each of these criteria, highlighting the strengths and weaknesses of various types of evidence that can be submitted in merger cases. In addition, we explain that economics plays a significant role in merger cases by helping to define which questions a decision maker does (and does not) need to answer during an investigation, as well as the appropriate weight to place on each piece of the available evidence base, including that arising from internal documents and witness testimony.

Economic evidence must be understandable

In every jurisdiction, whether in court or in front of an agency, the decision makers will need to understand the economic evidence presented to them. Decision makers generally require economic advisers and experts to explain their evidence clearly and convincingly before they are willing to grant it evidential weight. Successful economists therefore place a heavy emphasis on clear communication.

Clear communication is particularly important because in many merger evaluation contexts an economic expert will not usually be explaining their analysis to other economists:

- First, the majority of merging-party executives do not have PhDs in economics, and may not have had any prior contact with the competition system.
- Second, while competition law professionals typically have at least some training in economics, most will understandably not wish to engage in a discussion of the merits of the economic analysis using technical language. Counsel want to understand whether the economic evidence is robust and helpful for their client.
- Third, whether the central lessons drawn from the economic evidence resonate with decision makers frequently hinges on whether and how these lessons fit with other evidence in the case, documentary evidence in particular.[2]
- Fourth, the fact that most decision makers themselves are rarely economists[3] means that the explanation of economic ideas in plain, accessible language is crucial. In an annex to an economist's expert report, it can be helpful to engage in a highly technical debate between economists; however, this will ordinarily be more effective for engaging in the debate with agency staff economists, rather than the decision makers.

In general, overly technical presentations of economic theory and empirical analyses can be hard for non-specialists to access effectively. The use of economic jargon and technical detail can materially hinder non-economist decision makers' understanding of economic evidence.

However, there are some situations in which technical details can enhance understanding and improve communication. One common example is when economic experts discuss a case under consideration by a competition agency. When an experienced PhD economist serving as an economic adviser is talking to an experienced PhD economist from an agency, the use of technical economic language is both common and necessary. For example, economists may discuss the statistical properties of regression estimators in a particular case by reference to the econometric literature considering merger policy.

Properly conducted and explained, economic evidence can help define which questions decision makers must ask and evaluate how much weight decision makers should place on specific pieces of evidence to answer a relevant question. We discuss each of these topics in turn.

Economic evidence must answer or inform the answer to a relevant question

Typically, competition agencies define a list of potential theories of harm relatively early in a merger investigation. The term 'Theories of harm' is a misnomer: the difference between a theory and a hypothesis in standard scientific terminology strongly suggests it would be more aptly termed 'hypotheses of harm'. Each jurisdiction's merger guidelines describe common hypotheses of harm associated with proposed mergers. These hypotheses include:

- Unilateral effects. Unilateral effects can arise in a horizontal merger when one firm merges with a competitor, allowing the merged firm to profitably raise prices (or worsen the value proposition to customers on non-price dimensions) on its own and without needing to coordinate with its rivals.[4]
- Coordinated effects. A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others.[5]
- Non-horizontal (non-coordinated) effects. These may principally arise when non-horizontal mergers give rise to foreclosure. The term 'foreclosure' is used to describe any instance where actual or potential rivals' access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies' ability or incentive to compete.[6]

For a given hypothesis of harm, economic evidence can help clarify the circumstances under which the proposed merger would be problematic. Generally, to find a hypothesis of harm credible, the decision maker must believe that each element underlying a hypothesis of harm is satisfied to the requisite legal standard, particularly in light of where the burden of proof lies.[7] For example, for a merger to have unilateral effects relative to a relevant counterfactual, it generally must be that:

- the merging parties are currently a significant competitive constraint on one another in one or more relevant markets;
- the remaining rivalry from non-merging parties active in the relevant markets is sufficiently limited that the loss of competitive rivalry because of a merger is significant;
- efficiencies are not sufficient to offset the loss of the competitive constraint; and
- new entrants are unlikely to replace the rivalry lost because of the merger in a timely and sufficient fashion.

If the authorities find that a hypothesis of harm holds true and so identify a problem with the merger, decision makers can then use economic evidence to help assess proposed remedies. Remedies must be effective and proportionate to the problem identified. Thus, in addition to helping identify potential problems with a merger, economic evidence can also shed light on the efficacy of potential solutions. However, when using economic evidence to evaluate remedies, some staff tasked with assessing remedies in some agencies will have accounting or general business backgrounds rather than an academic economics training. A highly technical piece of economic theory, therefore, may prove hard for some remedies staff to engage fully with and so may receive little evidential weight. Economic advisers need to adjust their approach and terminology accordingly.

Economic evidence can help define which questions a decision maker does (and does not) need to answer

To understand how economic evidence can help define which questions decision makers do and do not need to answer, or to prioritise questions in the face of limited resources, we consider two leading examples that distinguish the practical application of economics from economic theory.

No need to distinguish every plausible candidate market definition

As part of a merger assessment, competition authorities and merging parties regularly seek to define markets to calculate market shares and other measures of concentration. While market definition can proceed relatively formally following the processes described in the relevant merger guidelines, often it is more useful to calculate market shares under a variety of potentially plausible candidate market definitions. This can help decision makers to focus their efforts on the issues that will matter to the case. For example, if two candidate market definitions both predict a very small market share for each merging party, then it is likely unnecessary to distinguish between those two candidate market definitions. Economic analysis thereby allows for some resource prioritisation for both agencies and parties.

Understanding the dimensions of competition over which merging parties may have incentives to worsen their value proposition

Economic analysis in merger control is necessarily prospective; the task is to predict the future effects of a merger. A starting point in these analyses is to clarify the overlap between the merging parties. For example, two manufacturers may supply parts with broadly the same function, but a closer inspection of their products may demonstrate that there is little functional overlap and hence limited competition between the merging parties. This may deprioritise a more careful analysis of these products for the merging parties and the agencies.

For each area of overlap, the analysis frequently turns to a qualitative assessment of whether and how the merging parties compete. Often the focus is on prices, but it can also be over different dimensions of competition, such as innovation, terms of service, or quality. Economics can provide a framework with which to understand incentives to compete before the merger and, in particular, how incentives will change following the merger. This framework can help identify questions for document discovery and areas of potentially informative data analysis to prioritise. It is also likely to help the agencies shape their conversations with industry participants and correspondingly can help the merging parties and their advisers anticipate such conversations and prepare for follow-up discussions.

Economic evidence is often relevant to evidential weight

Importantly, the framework provided by economics in merger cases can also help decision makers weigh the evidence provided. It may be that factors relevant to weighing evidence will be laid out in a guidance document issued by competition authorities.

In this sub-section we present two examples where economic theory and insight can help decision makers define the appropriate evidential weight to apply to a particular type of evidence (whether empirical or documentary) in merger cases.

Evidential weight from market shares versus the likely effect of the merger on incentives

A prime example of how economic understanding can shape the way decision makers weigh evidence is the evolution of the role of market definition in merger control. A central lesson from economics is that market shares, considered alone, can be misleading when assessing the incentive effects of a merger. While analyses based on market shares continue to play a central role in merger evaluation, the role of market definition in merger practice has evolved over time. This evolution was reflected in the UK and US competition agencies' respective Horizontal Merger Guidelines of 2010,[8] which sought to reduce agencies' reliance on market definition, and the consequent market shares. Specifically, the guidelines place a greater focus on agencies' effort in merger evaluation on economic evidence relevant to assessing the actual competitive effects of the merger. This in turn requires that agencies give appropriate evidential weight to the actual incentive effects of a merger rather than relying on market shares alone. Put differently, no matter how markets are defined by agency officials, the actual competitive effects of a merger will remain the same, while the measured market shares may change with different market definitions.

In the UK, for instance, the formal or semi-formal use of the Hypothetical Monopolist Test to define markets has significantly reduced in favour of a more flexible approach to defining markets. This practice is referred to in the CMA guidelines as market definition providing only a 'frame of reference' for the actual analysis of the likely competitive effects of a merger. This evolution in approach has had the practical advantage of focusing agencies' attention on the relevant question of whether a merger will actually reduce the merged firm's value proposition to customers, for instance by raising prices or lowering quality.

Economics can help inform decision makers on whether and how market shares should be given evidential weight when used in conjunction with other pieces of evidence. And, of course, economics can also be crucially important for the competition agency's assessment of the incentive effects of a merger.

The counterfactual and the assessment of evidence on pre-merger market shares

Consider the potentially important role of the counterfactual in merger analysis. According to the EU, UK and US guidelines, the counterfactual ordinarily used in merger control is the pre-existing conditions of competition. However, this need not always be the case for a variety of reasons.

One particular case in which pre-existing conditions form a poor counterfactual is when one of the merging parties is a failing firm, or when the target is a failing division. If plan B, absent the merger, is for the target firm to completely or partially close the assets being acquired, then pre-existing conditions of competition, and in particular, current market shares, may markedly overstate the likely future extent of competition should the merger not proceed.

A second case in which pre-existing conditions form a poor counterfactual is when a target firm has well-developed and advanced plans to enter a market where the acquirer is active.

And a third case is where technological innovation changes the market landscape, such as where third parties develop new products that provide a constraint on the merging parties that was not there historically.

In each case, decision makers must be careful to assess the correct evidential weight to give to the pre-merger market share evidence, if any. Economic theory and intuition can be useful in identifying which counterfactuals are most suitable in the situation at hand, allowing decision makers to better weigh evidence on market shares.

Economic evidence must be worthy of evidential weight

Another crucial feature of useful economic evidence is that it must be found worthy of evidential weight. Agency staff and expert economists will seek to inform decision makers' views by submitting economic analyses and related evidence testing the assumptions, reliability and robustness of any significant piece of economic evidence submitted during merger control proceedings.

Testing reliability and robustness of economic evidence

To assess evidential weight, agencies and courts will evaluate the reliability of the economic evidence submitted to them. In the EU and UK, competition agencies have published guidance on 'best practices for the submission of economic evidence'.[9] In US courts, the reliability of expert evidence at trial has been codified in the form of the Daubert test.

One important aspect of reliability is that the results of a piece of economic analysis must be replicable (see, for example, the UK guidelines for submission of economic evidence).[10] The economic evidence can then be tested using statistical techniques to assess whether it is reliable and robust. For example, regression models can be tested both by checking the calculation and definition of explanatory variables included in the specification and also by testing whether the specification should include new or alternative variables. A regression analysis considering whether there is evidence of a causal relationship between price and higher concentration, for example, must control for movements in cost, suitably defined. To see why, suppose an economic expert obtained data from a set of local markets in a merger inquiry and found that high prices are associated with high concentration. If the analysis did not properly control for cost variation across markets, then this may just be revealing that high cost markets are associated with both high prices and few market participants (ie, high concentration) so that, once cost variation across markets is properly controlled for, no evidence of a causal relation between price and concentration may remain.

A second significant aspect of reliability is that the assumptions underlying a piece of economic evidence must be understood and tested. Assumptions may be implicit in pieces of economic analysis, but once drawn out explicitly can be tested against the available documentary evidence and witness testimony (see the further discussion of this point below).

Next, we provide an illustration of the way in which implicit assumptions in a piece of economic analysis can be made explicit and thereby affect the assessment of the proper weight to assign to a piece of evidence.

'Identification' and the need to distinguish between competing hypotheses

When economists are engaged by parties to submit evidence to a competition authority or court, the aim is to help decision makers distinguish between competing hypotheses. In its simplest form, decision makers seeking to improve consumer welfare must distinguish between the competing hypotheses that a merger is 'good for consumers' or 'bad for consumers'.

To do so, economists must look for data that distinguish the two scenarios using the framework of the hypotheses of harm. Empirical analysis that cannot distinguish between two hypotheses at issue is unlikely to be worthy of evidential weight.

For example, under a coordinated effects hypothesis of harm, suppose competition economists submit evidence that prices of firms in the industry move in parallel with one another. This type of evidence is well known to be potentially consistent with either one of two conflicting interpretations: costs moving together and competitive prices moving in parallel as a result; or firms tacitly coordinating movement in their prices. The fact that prices move together is consistent with either competitive or coordinated behaviour. In short, absent cost data, it is not possible to use the available pricing data to distinguish a problematic merger from a non-problematic one. As a result, the empirical evidence (in itself) will not be sufficient to distinguish (or in economists' terms, 'identify') whether or not a merger is problematic.

Challenges and opportunities

There are some areas where courts and other decision makers sometimes find it difficult to assess whether and how much weight to place on pieces of evidence. To close our discussion, we illustrate with a number of examples.

Evidence from documents

Documentary evidence often plays a very important role in cases and in many instances that is entirely justified. For example, a strategy document created in the ordinary course of business presented to the board after months of underlying work defining a company's competitor set and strengths and weaknesses relative to its competitors is likely to receive significant evidential weight. On the other hand, some documents can actively mislead, and it is certainly the case that not all internal documentary evidence will be worthy of substantial evidential weight. For example, competition agencies are ordinarily professionally sceptical of strategy documents created in anticipation of the specific merger under investigation, reasoning that the parties may take legal advice that shapes those documents to appear favourable. Other documents may say very unhelpful things for merging parties but, on investigation of the context in which they were produced, turn out to have been written by mid-ranking staff, contain and rely on little convincing evidence or argumentation, and contain proposals that were subsequently dropped or otherwise rejected by more senior individuals in the business. Thus, it can be important to understand the context and motivations of the author of a document to decide upon its import.

Evidence from economic theory

Economic modelling provides, at its best, a series of 'if-then' propositions. If the 'if' is wrong, that is, if the model's assumptions do not correspond with relevant facts in the case at hand, then the 'then' will also be wrong. Of course, in actual cases, economists often deal with approximations, so that the relevant question is usually whether the 'if' is a sufficiently good approximation to the facts of the case that the economic theory in question provides reliable insight into the effects of the merger. Professional economists may sometimes reasonably disagree with each other regarding the applicability of a certain model or assumption, and decision makers may also reasonably take an independent view. In general, decision makers struggle with abstract economics and economists are ordinarily more comfortable making assumptions than the decision makers. Clearly, the best practice is to ground economic assumptions in evidence wherever it is feasible to do so, and to highlight where it has not been feasible.

Evidence from industry participants

As a part of a merger investigation, competition agencies often launch an effort to collect information from industry participants; in the EU, this is known as the market investigation. This involves reaching out to a subset of firms in the industry, suppliers and customers to collect information on each of their perspectives about the merits of the merger. Merging parties sometimes do the same, collecting statements from particular industry participants in support of the merger.

Competition agencies and merging parties sometimes consider or present the results of their market investigations (informal surveys) as definitive, even though such evidence may not have been collected in a way that reflects best practices in survey design. While such information can be helpful, there are reasons to believe it should be treated carefully: a merger that would lead to a significant increase in prices may be welcomed by competitors. Conversely, a merger may be viewed adversely by competitors if they expected it to generate significant efficiencies and strengthen competition. Similarly, the incentives and actions of customers may require careful thought. For example, customers may seek to leverage the fact that their evidence may be either helpful or unhelpful in a merger inquiry into obtaining more favourable terms in ordinary commercial negotiations. Respondent incentives can be particularly complex to understand in vertically integrated industries, where respondents may be both customers and competitors of the merging parties in different levels of the industry.

Survey evidence

Formal surveys require careful design work in accordance with best survey design practice. While survey evidence plays an important role in a large number of cases (and has done so for decades in some jurisdictions, particularly the UK), developing genuinely unbiased questions and asking them to a suitable representative sample is often very challenging to do in practice. Furthermore, there can of course be a difference between how customers state their preferences in surveys and how customers would actually act, that is, reveal their preferences, in the real world.

Evidence from past mergers

Another example of evidence that can be challenging for decision makers to weigh is the economic evidence that arises from evaluating past mergers. Absent direct information about the effects of a merger under investigation, one indirect source of evidence about a merger's potential effects is to examine the impact of past mergers on either prices or efficiencies.

Evidence about the similarity and relevance of past mergers to the circumstances at issue in a current case may be challenging to develop. Because no prior merger is likely to offer a perfect parallel to the present merger, it can be important to tie any learning from prior mergers into economic modelling of the present merger, as well as documentary evidence and customer testimony.

Conclusions

Economic evidence plays a crucial role in competition cases. To be persuasive to decision makers, economic evidence must be understandable, relevant and worthy of evidential weight. If economic evidence fails to achieve any one dimension of these criteria, it will likely receive very little evidential weight from decision makers, whether in competition agencies, tribunals or in court. In addition, economics plays a significant role in helping to define which questions a decision maker does (and does not) need to answer during an investigation, and the appropriate weight to place on each piece of the available evidence base, including that arising from internal documents and witness testimony.

Endnotes

1 The views expressed herein are solely those of the authors and do not necessarily represent the views of Cornerstone Research.

2 For a case study on tying complex economic evidence to documents and testimony, see Aviv Nevo et al, 'The Aetna-Humana Proposed Merger', in *Antitrust Revolution, 7th ed*, eds John Kwoka and Lawrence White (Oxford University Press, 2018).

3 There can be exceptions. For example, some panel members deciding the UK Competition and Markets Authority (CMA)'s Phase II merger investigations are economists, as are some Tribunal members serving on cases before the UK Competition Appeals Tribunal.

4 Competition Commission and the Office of Fair Trading, Merger Assessment Guidelines, CC2 (Revised) OFT1254, September 2010, paragraph 5.4.1.

5 US Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, 19 August 2010, p24, https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

6 See 'Guidelines on the Assessment of Non-horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings', *Official Journal of the European Union* 265 (18 October 2008), paragraph 18, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC1018(03)&from=EN.

7 The burden of proof can shift depending on the question in a merger inquiry. For example, in the EU Merger Regulation the burden of proof for establishing efficiencies is placed on those proposing the merger: '[I]t is appropriate to take account of any substantiated and likely efficiencies put forward by the undertakings concerned'. Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation),

paragraph 29, emphasis added. In the US, the burden of proof begins with the government but shifts to the merging parties if the government can demonstrate a 'structural presumption' of harm based on the level and increase of concentration in one or more appropriately defined relevant antitrust markets. See, for example, discussion in Herbert J. Hovenkamp and Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, University of Pennsylvania Law School Legal Scholarship Repository, 2018.

8 In the US, the Horizontal Merger Guidelines were issued on 19 August 2010 by the US Department of Justice and the Federal Trade Commission. In the UK, the Merger Assessment Guidelines were issued in September 2010. In the EU, the Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings (2004/C 31/03) were issued in 2004 and have not been updated since. Nonetheless, much of the economic toolkit, including the discussion of upward pricing pressure tests, endorsed by the UK and US when issuing their Horizontal Merger Guidelines in 2010 has also played an important role in casework in the EU in recent years.

9 DG Competition, Best Practices of the Submission of Economic Evidence and Data Collection in Cases Concerning the Application of Articles 101 and 102 TFEU and in Merger Cases (working paper, European Commission), http://ec.europa.eu/competition/antitrust/legislation/best_practices_submission_en.pdf.

10 Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission. See Competition Commission, Suggested Best Practice for Submissions of Technical Economic Analysis from Parties to the Competition Commission, CC2com3, 1 February 2009, https://www.gov.uk/government/publications/economic-analysis-submissions-best-practice. As the name suggests, this guidance was originally published by the UK Competition Commission. When that organisation was merged with the UK Office of Fair Trading to form the UK Competition and Markets Authority, the guidance was formally adopted by the CMA Board at the point of transition and remains in force today.

CORNERSTONE RESEARCH

Peter Davis
pdavis@cornerstone.com

Kostis Hatzitaskos
khatzitaskos@cornerstone.com

4 More London Riverside, 5th Floor
London SE1 2AU
United Kingdom
Tel: +44 20 3655 0900
www.cornerstone.com