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CHATHAM HOUSE COMPETITION POLICY 2023: BACK TO THE FUTURE FOR COMPETITION POLICY

SUMMARY OF KEY POINTS

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The frontiers of competition policy are rapidly expanding driven by deglobalization, inflation, the rise of big tech and the green transition. As competition authorities and antitrust regulators navigate these fields, a revival of traditional methodologies and approaches is gaining traction.

Recent years have seen new regulatory regimes for subsidies and digital markets which draw on existing competition policy frameworks; however, the consistency of competition policy enforcement across jurisdictions remains a question.

Compliance requirements have also become more complex as many major jurisdictions retreat from economic effects-based approaches towards more form-based and ex-ante regulation creating an uncertain environment for international businesses and investors.

Members of the legal government, academic and business communities discussed these themes at the Chatham House Competition Policy Conference on 9 November 2023, which was held under the Chatham House Rule. The main points that were made by participants are summarised below.

SUBSIDIES, SUSTAINABILITY AND SUPPLY CHAIN STABILITY

Effective use of subsidies

The Covid pandemic and the war in Ukraine have exposed weaknesses in the assumption that markets are efficient allocators of resources, bringing new political impetus for sustainable and resilient supply chains for medical supplies, energy and other critical inputs. This has been underpinned by subsidies of around USD 20 trillion, globally, across different industries and countries, and including record levels of State aid in the EU in recent years. However, to achieve climate reduction goals of the Paris Agreement significant private sector investment will be required.

Economic evidence suggests that Government subsidies are more effective when adopted in markets with competition, and designed in a way that promotes competition, such as the USD 1 billion subsidies granted to the US meat packing industry. The EU seeks to follow these guiding principles in its subsidy policies. One participant gave the example of the EU Chips Act, which is intended to increase the EU's efficiency and security of supply in that sector, to address market failures in semi-conductor eco-system and to create beneficial spill-over effects. Another participant expressed uncertainty that the Chips Act would achieve those aims, given how difficult it is to create new technology clusters. They highlighted the benefits that more targeted support can have for addressing market failures with an example of subsidies that had allowed their employer to develop a product for which market demand had not fully materialised at the time.

There are ongoing discussions between the EU and the US regarding the impact of subsidies under the Inflation Reduction Act on EU businesses, so there are no grounds for proceedings under WTO rules or the new EU Foreign Subsidies Regulation (**FSR**) at present.

Economic analysis of merger subsidies under the FSR

The FSR requires the European Commission (**EC**) to establish the distortive effects of a subsidy on the EU internal market before it can take action, unlike EU State aid rules which typically assume such effects. In the context of subsidies that facilitate M&A transactions, which are caught by the new regime, there are various ways in which such distortions might arise, but each will depend on the facts of the case:

- Distortions of the market for "corporate control". A subsidy may allow a buyer to outbid others that would have run the target assets more efficiently. However, if mergers do not typically give rise to efficiencies (which EU merger control decisions suggest to be the view of the EC) then this type of distortion may be less likely, and

to establish such a distortion would require a counterfactual analysis of the other potential bidders, and their valuation of and plans for the target.

- A buyer might benefit from subsidies that distort competition in market for goods or services, such as operating aid. But these may not be distortive if the market is characterised by market power, as in that case production is already reduced below the optimal level and subsidised production will serve to redress that market failure.
- Distortions of incentives to invest in production, e.g., through subsidised financing or State guarantees granted to a parent company, which allow over-investment in a European subsidiary. Many studies suggest that greenfield investment can crowd out domestic investment, but it can also crowd in investment by EU businesses in related (e.g., upstream or downstream) sectors, making the net distortive effect minimal. While there are fewer studies of this effect in an M&A context, they typically do not show significant effects one way or the other, which may be logical as the acquisition itself does not bring any new money into the target's business.

The above analysis suggests that adapting subsidy analyses to the M&A context is complicated and that there should be no presumption that such subsidies negatively distort competition.

Balancing policy objectives of non-EU countries under the FSR

The FSR's balancing test allows the EC to balance the negative effects of a foreign subsidy against positive effects on economic activity in the EU, as well as broader positive effects for policy objectives, in particular (but not limited to) those of the EU. The extent to which this may result in the EC deciding which policy objectives other countries may legitimately pursue is an area to be explored, but any such assessment will be required to respect a principle of non-discrimination between the application of the FSR and EU State aid rules, and the requirement that any action taken against a subsidy must be limited to addressing its distortive effect within the EU. It was recognised, however, that the balancing exercise could be challenging and may lead to political controversies with other jurisdictions.

EXPANSION OF MERGER CONTROL AND INVESTMENT SCREENINGS

Draft revisions to the US merger assessment guidelines

Proposed revisions to the US agencies' merger assessment guidelines were much discussed. It was explained that the revisions represent an assertion of a more interventionist merger policy by aligning the limits of the agencies' legal authority under the case law of US courts with the best of modern economic thinking. In particular, they seek to achieve two cross-cutting aims. First, to address all dimensions of competition by explaining how the agencies assess effects of a merger on factors such as quantities, quality, innovation, customer attention and wages when it is not possible to do a full pricing analysis (e.g. because there is a zero price for the products or services of the merging parties) and how they assess mergers involving platforms, which may affect competition on the platform, with the platform or to displace the platform. Second, the revisions aim to cover all regularly used theories of harm, many of which are not included in the current guidelines, such as entrenchment of a dominant position (as applied in *Visa/Plaid*). The draft guidelines aim to set out various different pathways and principles that can be used to assess mergers, but how they will be used and developed will be determined through cases and analysis. While consumer welfare is still a guiding principle (or, more accurately, "trading partner welfare", which captures labour market effects), it is intended to be assessed in a dynamic way, for instance by considering impacts on future consumers as well as current consumers.

One aim of the revised guidelines is to remove unhelpful labels. For example, labelling a merger as a vertical merger can understate its potential to impact horizontal competition. When bringing cases involving vertical mergers before the courts, US agencies have had difficulty in explaining economic concepts such as the elimination of double marginalisation and foreclosure. It is easier and more intuitive to explain that the two parties are competitors and that one has something that the other needs, and which can therefore be used to do harm to a rival, e.g., by withholding or degrading the input. This applies the traditional framework for assessing ability and incentive to foreclose but casts it in a different way. Similarly:

- while the draft guidelines do not refer to conglomerate effects (partly because some conglomerate theories do not line up with modern economic thinking), the guidance on entrenchment is intended to cover these kinds of theories of harm; and
- the draft guidelines refer to lessening of competition rather than the creation or entrenchment of market power, but this is not intended to mean something completely different.

Market definition in the draft guidelines has been subtly refined. In cases where market definition is too difficult or uncertain, the guidelines would allow markets to be defined more broadly and for the agencies to focus on the substantive effects in that market more quickly. One consequence of this is the hypothetical monopolist test (**HMT**) has been placed on equal grounds as other ways of defining the market, which was necessary because in many cases (*e.g.*, markets in which there is zero pricing) it is not possible to carry out a HMT.

Much of the commentary on the revisions has focused on the use of structural presumptions based on e.g., market shares and measures of market concentration. Participants asserted that such presumptions should not be relied on to avoid a full and proper assessment of effects and recognised that there may be various factors that parties could use to rebut the presumptions. The next version of the guidelines will likely make it clearer that these presumptions are rebuttable, as well as other significant changes (the final version of the guidelines were subsequently published in December 2023).

A business participant considered that the proposed revisions would reduce certainty and predictability of assessments (e.g., by introducing non-traditional competition factors such as impacts on labour markets) and were concerned that the agencies' "preference for internal growth over acquisitions" (as stated in the revised guidance) was foreboding for dealmakers. They also had doubts that the proposals were consistent with recent court decisions and, in particular, that the very low thresholds for many of the structural presumptions would be accepted by courts as justifying a reversal of the burden of proof. Another participant considered there to be a strong basis for such presumptions in US court case law and that it was reasonable to ask parties to explain why, for example, a horizontal merger in a concentrated market is benign, given that such mergers are so often dangerous. It was noted that the guidelines are not binding on the courts but are often cited by the expert witnesses that give evidence and by the courts themselves. The agencies are likely to litigate cases by leading with the effects analysis and then reinforcing that with the applicable presumptions.

Private equity "roll-up" acquisitions

"Roll up" acquisitions involving multiple acquisitions in the same sector, often by private equity (PE) investors, feature both in the revised US draft guidelines and in recent enforcement activity (in the veterinary services sector) of the UK Competition and Markets Authority (**CMA**). The latter appears not to be motivated by any adverse assumptions about private equity business models but has instead been based on a traditional assessment of the effects of the mergers in question in local markets which would not have been any different for a non-PE buyer. While one participant thought that the US is less agnostic to business models of acquirers, another considered this only to be the case for acquirers with a proven business model of engaging in multiple acquisitions for the purpose of obtaining market power. It was also noted that the EC's 2021 revision of its Article 22 referral policy (which now allows mergers to be assessed by the EC even if they fall below the thresholds of all national merger control regimes in the EU) was partly a response to such roll-up strategies, as they often involve individual transactions that are too small to meet filing thresholds.

Eco-system theories of harm

The recent *Booking.com/eTraveli* prohibition decision of the EC relied on an "eco-system" theory of harm, i.e., that the acquisition of eTraveli's online flight booking platform would strengthen Booking.com's dominant position in online hotel booking platforms, by allowing Booking to capture more of eTraveli's customers. The CMA cleared *Booking/eTraveli* unconditionally, although this might be explained by the merging parties' different market profiles in the UK. One participant commented that EC's prohibition was remarkable because the EC did not assess whether the combination of these complementary services would foreclose competitors, so departing from the approach set out in its own non-horizontal merger guidelines. The EC had done the same in some other recent mergers, such as *Google/Photomath*, but those mergers were cleared. It was explained that, like the US agencies, the EC is reflecting on whether its current guidelines and tools are fit for purpose, in particular in their assessment of potential effects of mergers in the long term. In this respect, it has been emboldened by the recent court judgment in the *CK Telecoms* appeal which confirmed that the EC is to apply the same standard of proof for all theories of harm that it considers.

There was discussion of whether eco-systems theories of harm could be applied outside the digital sector, e.g., wherever merging parties sell complementary products or services. One participant considered that it would likely be limited to markets characterised by strong network effects (often the case in digital markets). In such cases, depriving rivals of access to "nodes" on that network (e.g., in the form of customers) can exacerbate the network effects. In contrast, adding functionality without depriving rivals

of network nodes, as was the case in *Google/Photomath*, does not give rise to such concerns. Another reason to take an adverse view of such transactions is that there are diminishing returns from scale, such that larger players benefit much less from acquiring a portion of the network than smaller ones.

Divergence in *Microsoft/Activision*

In *Microsoft/Activision*, the CMA rejected a remedy (to licence cloud gaming rights to all third parties) that had been accepted by the EC and held out for a more structural remedy in the form of divestment of the relevant cloud gaming rights to a third party, which it ultimately obtained. It was observed that in the relatively small number of cases in which the EC and CMA have diverged, the differences can usually be explained by different market conditions, enforcement priorities and legal traditions.

In *Microsoft/Activision*, the EC's legal framework did not allow it to reject credible remedies without market testing and that testing led the EC to conclude that Microsoft's proposed remedy would have been effective because it required MS to license the relevant cloud gaming rights to all parties, without discrimination and did not require significant monitoring. The CMA, in contrast, was concerned that the initial remedy may not be sufficiently flexible to accommodate all cloud gaming business models, including those that may be developed in the future.

Behavioural remedies

Behavioural remedies in merger control are now less likely than in the past to be accepted by US, EU and UK agencies in cases giving rise to non-horizontal competition issues, requiring parties to assess the issues much earlier and consider up-front / fix-it-first remedies in appropriate cases. A particular issue in the US is that remedy settlements have to be justified to the courts, so agencies are not eager to advocate for remedies unless they are certain that they fix the relevant competition problem.

Foreign investment and national security screening

While FDI and national security screening regimes have proliferated in recent years, levels of intervention as a proportion of notified or reviewed cases are relatively low, which suggests that the thresholds and definitions that determine filing requirements should be tightened to exclude more transactions.

One participant highlighted the issue of intra-group transactions which are now subject to mandatory notification in multiple regimes. These create significant risks for multi-national businesses. For example, a US business may have a European subsidiary with activities in a sensitive sector that was acquired before an FDI regime was in place and therefore be unaware that a transfer of shares in one if its US-based intermediate holding companies triggers a mandatory filing with criminal penalties for failure to file.

COMPETITION POLICY AND ARTIFICIAL INTELLIGENCE

As regards AI regulation in general, the recent US executive order shows that the US has thought more broadly than a focus on the low-probability, existential risks that might be posed by AI, covering also risks that are more likely to affect people's lives, such as deep fake photos and bias in AI algorithms. It was observed that the benefits of AI are often overstated, which can result in the potential harms being overlooked.

There are moves towards legal regulation of AI in the EU and the UK, with the US considering it, although passage of the EU's AI Act has been affected by concerns of the French Government that the legislation could affect its own AI players, such as Mistral (a provisional agreement on the AI Act was subsequently reached between the EU legislative bodies in December). The UK plan, set out in a white paper, is to entrust regulatory functions to existing regulators such as the CMA, the Financial Conduct Authority, Ofcom, and the Information Commissioner's Office, which will collaborate through their Digital Regulation Cooperation Forum (**DCRF**). In contrast, China views data differently, as a means to control rather than as a commodity, but it is important to include China in the discussion, as all major global players will be required to address risks such as the use of AI for the development of chemical weapons.

The competition issues that may be posed by AI were considered in a recent CMA report on AI Foundation Models. This recommended regulation on the basis of principles such as accountability, access, diversity, choice, flexibility, fair dealing and transparency. A number of potential future competition risks were identified, such as a lessening of competition for deployment of AI models caused by M&A, the emergence of a market leader that stifles innovation, barriers to switching, eco-systems that restrict choice and inter-operability, tying and bundling and false or misleading content. It was considered desirable to have regulation in place before the harms arise, but difficult to design such regulation while the market is developing so rapidly. It was also considered likely that AI would inevitably become dominated by a small number of firms, given the huge investments, computational capacity and technical skill sets required.

One participant considered it important to focus on the use to which AI technology is put, rather than the technology itself. Their view was that there are currently no good solutions for problems such as how to remove bias from a data set before training an AI model. Data for training models is scraped from the internet in an indiscriminate way, with little transparency on the reasons for their outcomes or the source of the data on which they are based. They therefore considered that the burden should be on businesses to show that their AI models do not lead to certain harmful outcomes for consumers.

REGULATION OF DIGITAL MARKETS

EU and UK legislation regulating digital markets.

The UK's Digital Markets, Competition and Consumers Bill (**DMCC**) adopts a flexible model of ex-ante regulation that is tailored to businesses that are considered to have "Strategic Market Status" (**SMS**) on the basis of their significant and entrenched market power. The EU's Digital Markets Act (**DMA**) goes further than the DMCC in specifying in advance which conduct will be illegal, with a set of 22 rules to govern the conduct of companies that are found to meet the criteria for designation as a digital "gatekeeper". The UK regime leaves it to the CMA to determine the rules for each business with SMS, within broad categories of conduct and on the basis of certain principles such as fair-dealing, open choices and trust and transparency. This difference may be less pronounced than first appears, as the DMA rules are likely to be less "self-executing" than expected and will require some tailoring to the circumstances of each gatekeeper and its markets. Nevertheless, the more generic approach to rulemaking does carry a greater risk of unintended side-effects. For example, one may think that the DMA should be seeking to make life easier for Microsoft's Bing search engine, which has a tiny market share, so that it can compete better with Google, but as Bing meets the quantitative criteria for designation as a core service of a gatekeeper under the DMA, it is now having to rebut that designation.

Ex-post regulation such as competition law has proved less suited to dealing with harms that are developing and can only be predicted with a certain degree of likelihood. The impending DMCC regime broadly mirrors the framework for regulation that was proposed by the 2019 Furman Report, although the authors of that report have written an open letter to the Government cautioning against introducing further checks, balances and evidentiary requirements that would make the DMCC regime more like competition law. The regime broadly shares the same objectives as the DMA, i.e., to open up markets to competition and, to the extent that is not (or is not yet) possible, to limit the ability of large digital firms to exploit or leverage their positions into new markets. In many of the markets regulated by the DMA and DMCC there may be minimal change for some time, but when the next big disruptive innovator comes along the new regimes will make it possible for them to make headway. The new regimes are also likely to reflect similar thinking on remedies, as many of the remedies suggested by the CMA in its digital advertising and mobile eco-system market studies are also coherent with the requirements of the DMA.

The CMA will be led by evidence of harm for UK markets and consumers but given the global nature of many of the relevant issues it will be consulting widely with other international agencies, as well as liaising with other UK agencies through the DCRF. It will be informed by information gathered in previous market studies, including the ongoing cloud market investigation, and this may allow the CMA to specify the conduct requirements for some firms' services quite fully and quickly when the regime is in place. Through its powers to prevent SMS firms from leveraging their positions into adjacent markets, the CMA will also be able to regulate the development of nascent adjacent markets, to create guard rails and to prevent them from also becoming subject to significant and entrenched market power. For example, AI technologies sit at a level of the supply chain that is both an input to, and output from, the cloud market and so may contribute to the level of market power that exists in the cloud market.

As regulatory regimes, economic evidence will primarily play a role in the determination of the rules under both the EU and UK regimes, rather than (as is the case in competition law) the determination of whether the rules have been breached. The enforcing agencies will need to balance the need to address harms swiftly with the avoidance of regulatory errors that may happen if action is taken too hastily.

The role of competition law enforcement

Competition law enforcement will continue to play a significant role in the digital sector but is likely to be more focused on firms and areas of activity that are not subject to regulation under the DMA and DMCC. Private enforcement is likely to continue to play some role even in the areas covered by the DMA and DMCC, as its primary aim is to typically secure compensation rather than secure behavioural changes, and there will continue to be cases that private claimants want to bring

that the CMA and EC are less interested in pursuing under the regulatory regimes. Learnings from private enforcement cases and regulation elsewhere in the world is likely to feed into incremental changes to the scope DMCC and DMA regulatory regimes. The CMA has also intervened in all of the collective actions proceedings under competition law that have been certified so far, to ensure that the Competition Appeal Tribunal has its views on those cases.

In the UK, recent standalone private enforcement of competition laws in the digital sector has often involved theories of harm that are more akin to consumer protection (e.g., data privacy) than traditional competition issues. The interplay between the new digital regulatory regimes and private enforcement may have implications, in particular, in the area of pricing. For example, an obligation to price on fair and reasonable and non-discriminatory (**FRAND**) terms under the DMA or the DMCC might imply a requirement for lower prices than would be required under abuse of dominance rules, the latter prohibiting only prices that are "excessive". A UK court recently confirmed in a judgment relating to standard essential patents that it considers there to be a gap between these concepts. It will be tricky for firms to argue that their prices may be unfair or unreasonable under a FRAND standard, but at the same time are not excessive for the purposes of competition law, and this is likely to mean that FRAND determinations under the DMA will have implications for how gatekeepers can price in other jurisdictions.

However, there may be a policy rationale for allowing firms to set prices that are not excessive, but above FRAND, in order to preserve incentives for them to create markets in the first place. More broadly, the behavioural changes that will be required by the DMA and DMCC will greatly reduce the incremental costs of introducing those same changes in other jurisdictions, so it will be easier for regulators and courts outside the EU and UK to impose similar remedies.

Cooperation and divergence in digital market regulation and merger control

There is a defensible argument that if earlier mergers had been blocked (e.g., in the social media sector) there would have been less need for ex-ante powers now. Unlike the position in the US, EU and UK merger control laws cannot be applied to unwind a merger that has previously been considered by the agencies, and it is difficult to impose a break-up or divestment remedy under abuse of dominance rules, as the remedy has to be a proportionate way to address the specific abuse in question. However, it was recognised that there is much uncertainty over whether a small target in a digital merger would succeed or fail absent the merger. That uncertainty gives rise to greater potential for divergence between merger control agencies and for over-enforcement, with several recent tech mergers being blocked by one major authority but cleared unconditionally by others.

There has been long-standing international cooperation, e.g., through the ICN, OECD and G7. Now that the EC has a formal mandate to enter into cooperation agreement on information sharing between the EU and UK, it is hoped that negotiations will proceed at pace. Broad consistency across jurisdictions has significant value, as the costs of having to provide different services in different jurisdictions inevitably feeds through to users. Consequently, while the rules that the CMA designs under the DMCC should not necessarily be the same as those applicable under the DMA, the implications of any divergence should be carefully considered. Possible reasons for divergence include differing societal aims (e.g., a greater focus on protecting small businesses in the EU vs. the US), different market conditions, differing degrees of independence between agencies (with some being more susceptible to political interference) and the possibility that one agency is ahead of others in understanding the issues. It may also be the case that agencies have different evidence made available to them, even though the facts are broadly the same – cooperation between agencies is the key to reducing this risk.

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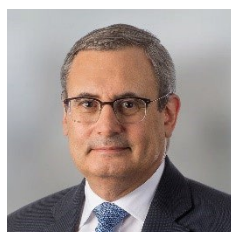

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