

RESILIENCE AND COMPETITION POLICY

The CMA's CEO (Andrea Coscelli) has co-authored an Economics Working Paper entitled "[Resilience and Competition Policy](#)", which looks at what role competition policy might play in building more resilient markets.

Market features indicative of supply chain vulnerability

Through several examples drawn from various sectors (UK audit, credit rating agencies, aircraft manufacturing, PPE, semiconductors, CO2, shipping, care homes, construction, and UK energy retail), the paper first identifies features of markets which make them vulnerable to supply disruption and discontinuity in the face of shocks or rapid structural change, and second identifies why disruption in some sectors of the economy causes more harm than in others.

The paper identifies the following inter-related market features as contributing to fragility: (i) market concentration, and particularly the presence of market power; (ii) the financial resilience of suppliers, and their vulnerability to changes in trading conditions; and (iii) supply chain dependencies, and in particular whether there is upstream dependency for key inputs on a small number of suppliers and/or particular geographic locations.

The paper also identifies key features that can aggravate or prolong the harm caused by disruption to supply, including: (i) the extent to which the product in question is essential, such that it cannot easily be substituted for alternatives in the face of shortages or supply discontinuity; (ii) whether there are significant barriers to the entry (and expansion) of new suppliers, which can prolong disruption; and (iii) whether the good or service is supplied to vulnerable consumers, who may be at greater risk of harm when supply is disrupted.¹

These conclusions on market structures do not appear to be significantly controversial. Where the paper breaks new ground is in the role it sees for competition policy in helping to shape more resilient markets.

The role of competition policy: the consumer welfare standard

Consistent with recent trends to reconsider the concept and role of consumer welfare in competition law enforcement, the paper notes "*that the concept of consumer welfare - particularly when considered over the long term - is more malleable than is often characterised, and accommodates resilience considerations. Consumer welfare is profoundly affected by disruption to supply, particularly when it occurs in markets for essential goods and services. Competition authorities, including those that apply a "consumer welfare standard", can and should take into account the risk and impact of such disruption in their decision making.*"

The paper holds up the approval of audit mergers in the 1990s and blessing of shipping alliances/mergers as examples where longer run resilience was not considered but should have been: "*[a] closer focus on these features [that underpin resilience], and the value that customers gain from supply continuity and predictability, would eliminate mistakes from competition analysis. In particular, it would help both competition authorities and policymakers to ensure a balance is struck between efficiency over the short-term and resilience over the longer-term that better reflects consumer interests.*"

Proposals for merger control reform

Picking up this theme, the paper argues for "*closer scrutiny of a transaction (or a series of transactions) in a concentrated industry with material barriers to entry and expansion...if: (i) it results in higher leverage (thereby raising the likelihood of exit in the event of a*

¹ The impact of transactions or corporate behaviour on vulnerable consumers is an increasing area of focus for the CMA when exercising its competition enforcement powers. See, for example, footnote 4 of the CMA's revised Merger Assessment Guidelines.

shock); and (ii) is in a market supplying essential goods or services (raising the harm caused by the exit).” The paper notes that this should especially be the case if regulation to prevent or mitigate the effects of disorderly exit is absent or ineffective. This is a novel suggestion.

Merger control in the UK is based around whether there is a substantial lessening of competition (SLC). This term is not defined in the Enterprise Act (the legislative basis for UK merger control) but the explanatory notes to that Act explain that: “[t]he concept is an economic one, best understood by reference to the question of whether a merger will increase or facilitate the exercise of market power (whether unilateral, or through co-ordinated behaviour), leading to reduced output, higher prices, less innovation or lower quality or choice.”

The paper’s proposal, therefore, appears to need a legislative footing, however, were this proposal to be taken up it would pave the way for the CMA to prohibit mergers where there is no horizontal, vertical or conglomerate theory of harm, but where the CMA considers that the purchaser has (in the CMA’s view) over leveraged: in this regard the paper singles out private equity acquisitions as driving a shift to more highly-leveraged capital structures. Further, this would relate to markets which Parliament had not considered sufficiently important to introduce regulation or where they had but in the CMA’s view this regulation is ineffective.

Possible changes to analysis within the existing framework?

Whilst the above change to the merger control regime would appear to necessitate legislation, we may well see concepts of “resilience” begin to impact CMA decision making, indeed the paper notes that:

- “in markets characterised by high barriers to entry and expansion, competition authorities should be cautious in allowing significant concentration as it might give rise to the problems [with respect to resilience] and potential ex post fixes might be costly and difficult to deliver; [and...]

- *authorities may wish to discount, to an appropriate extent, the competitive pressure arising from overseas suppliers in a market if they are concentrated in a particular geographic location (and therefore vulnerable to the same localised shocks).”*

Each of these concepts could conceivably fall within the analysis of mergers within the existing legal framework. In doing so, they would chime with the CMA’s appetite to accept “more uncertainty” when framing theories of harm, and thereby further increase the challenge for negotiating parties to assess the CMA’s likely view of a transaction.

Although it seems probable that many mergers where these concepts could potentially feature in the CMA’s analysis would likely be challenging also on traditional grounds, this may not always be the case, for example, where imports from a particular region are a key and established factor of competition. Accordingly, it is hoped that the CMA will develop clear guidance as to the role that these concepts may play and how they will be balanced within traditional analysis before they are explored in merger control reviews. In this regard, it is notable that supply-chain resilience did not feature in the CMA’s recently revised Merger Assessment Guidelines, which instead were focused on traditional theories of harm (albeit the revised MAGs developed a more expansionist approach to these traditional theories conducive to greater intervention).

As a final observation, whilst not assessing relevant cases in detail, the paper is dismissive of the suggestion that concentrated markets could in fact be more resilient. Echoing the sentiments from the European Commission following its prohibition of Siemens/Alstom, it is also sceptical that the creation of national/regional champions should be capable of clearing a potentially anti-competitive merger on efficiency or resilience grounds.

It remains to be seen whether and how the concept of resilience will impact the CMA’s future merger analysis.

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