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The Concept of Potential Competition – Note by the United Kingdom

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More documents related to this discussion can be found at https://www.oecd.org/daf/competition/the-concept-of-potential-competition.htm

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1. Introduction

1. Potential competition means the constraint undertakings currently outside a market are able to exert through the prospect that they will enter that market. At the moment undertakings enter they become actual competitors. Until then potential competition merits equal protection in law to actual competition. If this were not the case, undertakings would be able to deny consumers the benefits of actual competition by preventing it from materialising.

2. Potential competition is therefore not hypothetical: it has real-world implications. Undertakings already on the market, or considering entering, can be expected to take into account the prospect of other undertakings entering, and to adapt their behaviour accordingly.

3. This paper sets out the approach of the UK Competition and Markets Authority (CMA) when considering potential competition issues with reference to the CMA's mergers and antitrust guidance and experience.

4. The paper is structured as follows:

- Section 2 explains the CMA's approach to assessing mergers where the elimination of potential or dynamic competition may give rise to horizontal unilateral effects and its approach to assessing barriers to entry in mergers, with reference to the CMA's published Merger Assessment Guidelines (MAGs) which were recently revised in March 2021. This is considered under the following headings:
  a. Definition of potential competition
  b. Ways in which a merger can lessen competition
     i. Loss of future competition
     ii. Loss of Dynamic competition
  c. Considerations of entry and expansion as a countervailing factor in mergers.
- Section 3 considers the treatment and assessment of potential competition issues in UK antitrust cases. After reflecting on the legal test for potential competition (3a), it explains the CMA's experience by reference to several case studies (3b) under the following headings:
  a. Agreements and concerted practices between potential competitors
  b. Exclusion of potential competitors.

2. Mergers involving potential competition

5. In March 2021, the CMA published revised Merger Assessment Guidelines (MAGs).[1] These set out the CMA's substantive approach to its analysis when investigating

[1] Merger Assessment Guidelines (CMA129, March 2021): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/986475/MAGs_for_publication_2021_-.pdf

mergers. These guidelines have been brought up to date with current best practice. The CMA's previous merger assessment guidelines were published in 2010, and since then, markets have evolved and changed at a rapid pace. The revised MAGs have been updated to take account of the CMA's recent experience and case law.

2.1. Definition of potential competition

6. In the MAGs, 'potential competition' refers to competitive interactions involving at least one firm that has the potential to enter or expand in competition with other firms. Potential competition is relevant to the potential for a merger to substantially lessen competition[2] where, absent the merger, entry or expansion by either or both merger firms may have resulted in new or increased competition between them.

2.2. Ways in which a merger can lessen potential competition

7. Mergers involving a potential entrant can lessen competition in different ways. First, a merger involving a potential entrant may imply a loss of the future competition between the merger firms after the potential entrant would have entered or expanded.

8. Second, existing firms and potential competitors can interact in an ongoing dynamic competitive process, and a merger could lead to a loss of dynamic competition. Firms that are making efforts or investments that may eventually lead to their entry or expansion will do so based on the opportunity to win new sales and profits, which may in part be 'stolen' from the other merger firm. Incumbent firms that are making efforts to improve their own competitive offering may do so to mitigate the risk of losing future profits to potential entrants. In this sense, potential entrants can be thought of as dynamic competitors, even before they effectively enter and begin supplying customers. A merger may reduce the incentives of dynamic competitors to continue with efforts to enter or expand, or the incentive of incumbent firms to mitigate the threat of future rival entry or expansion. The impact of such a reduction in efforts would affect customers in the present, rather than solely from the future point in time when entry or expansion has occurred.

9. Losses of dynamic competition are more relevant when the investments involved in entering or expanding represent an important part of the competitive process, in industries where the process of entering markets takes place over a long period of time and involves significant costs or risks, or where key aspects of the competitive offering are set during the investment phase rather than flexed on an ongoing basis. Examples might include digital platforms, where the costs and time required to build up a significant user base and achieve network efficiencies might involve years of losses (with ongoing uncertainty about whether the platform would eventually be successful), or pharmaceutical mergers where investments in new products might involve years of investment in products that may never come to fruition.

[2] Part of the CMA's duty to promote competition is to investigate mergers between companies, to ensure that they do not result in a substantial lessening of competition. See Chapter 2 of the Merger Assessment Guidelines for further detail on what amounts to a substantial lessening of competition.

10. The following paragraphs discuss aspects of how the CMA approaches losses of future and dynamic competition in mergers involving potential entrants.[3,4]

2.2.1. Loss of future competition

11. In assessing whether a merger involving a potential entrant leads to a loss of future competition between the merger firms, the CMA will consider evidence on:

a. whether either merger firm would have entered or expanded absent the merger; and

b. whether the loss of future competition brought about by the merger would give rise to a substantial lessening of competition, taking into account other constraints and potential entrants.

12. The following paragraphs set out the CMA's approach to assessing the prospect and impact of potential entry.

Assessment of whether either merger firm would enter or expand

13. The CMA will typically consider entry by the merger firms as part of the counterfactual. In some cases, evidence relevant to the counterfactual and evidence relevant to the competitive assessment will be overlapping.

14. The CMA may consider a range of evidence on the prospect of entry by the merger firms. Entry may be considered more likely where a merger firm has the incentive and ability to enter; has well-developed plans or has already taken significant steps towards entry; where incumbent firms are taking action in anticipation of its entry; or where it has a past history of entry into related markets. The CMA has considered the likelihood of entry/expansion of merger parties in several recent cases (see **Error! Reference source not found.** below).

15. The decision to pursue a merger may supplant the creation of detailed business plans assessing alternative routes to enter or expand. Therefore, the CMA is likely to consider the merger firms' ability and incentive to enter.

16. For example, the CMA may conclude on the prospect that one of the merger firms would have entered absent the merger, without concluding on the precise characteristics of the product it would launch, or which particular assets (out of a set of possible options) it might acquire in order to enter.

[3] Losses of future competition and losses of dynamic competition are interrelated, as they both involve the constraint from potential entrants. As both depend on the likelihood of entry or expansion by a potential entrant, and the impact of such entry or expansion on competition, the CMA's assessment of each may to an extent rely on overlapping evidence. The CMA may therefore consider them together or separately.

[4] The MAGs discuss competitive interactions with potential entrants and also note that similar reasoning may apply to competitive interactions with firms that are already active in the market but have the potential to expand significantly. In addition, the guidance set out in relation to losses of existing competition (paragraphs 4.1 to 4.37 of the Merger Assessment Guidelines) is also relevant to the assessment of potential competition.

Table 1. Consideration of entry/expansion of merger parties in recent CMA cases

Case	Potential entry/expansion	Evidence relied on	Outcome regarding potential entry/expansion
Amazon.com NV Investment Holdings LLC/Roofoods Ltd (Deliveroo) (2020)[5]	Amazon re-entering the supply of online restaurant platforms in the UK	Internal documents Evidence from third parties Amazon's incentives to re-enter	The CMA considered that Amazon had a continued interest in online restaurant platforms and an incentive to offer this service. It also considered that there were multiple possible routes for entry for Amazon absent the merger.
PayPal Holdings Inc/iZettle AB (2019)[6]	PayPal expanding its offering for mobile point of sale services (i.e. offline payments). iZettle expanding its offering for online payments and therefore increasing its presence in the 'omni-channel market' for online and offline payments.	Internal documents IPO documentation Parties' submissions PayPal's incentives to improve its offline payment services capabilities	The CMA considered that PayPal would substantially improve or replace its mobile point of sale product and be a stronger competitor, but there were limitations in what PayPal could achieve in the shorter term to enhance its position. The CMA considered that iZettle's expansion into online payments would have remained relatively less developed and its omni-channel services would have proceeded and developed only at a slow rate.
Roche Holdings, Inc./Spark Therapeutics, Inc. (2020)[7]	Spark developing two Haemophilia A gene therapy treatments.	Concreate steps taken towards commercialisation Internal documents Third party views Roche's valuation of Spark – which showed confidence that Spark would obtain marketing authorisation	The CMA found that there was a realistic prospect that Spark would have succeeded in progressing through its R&D phase to achieve marketing authorisation within the foreseeable future.
Provisional Findings in Illumina Inc/Pacific Biosciences of California Inc. (2019)[8]	Improvements in PacBio's technology for next generation gene sequencing systems, which reduced the cost of its sequencing, allowing it to compete more closely with Illumina. Illumina developing technologies which compete directly with PacBio's 'long read' systems for sequencing DNA.	Internal documents Parties' submissions Illumina's incentives to compete in 'long read' sequencing	Improvements in PacBio's technology for next generation gene sequencing systems, which reduced the cost of its sequencing, allowing it to compete more closely with Illumina. The CMA provisionally found that Illumina considered 'long read' sequencing a critical and growing part of 'next generation sequencing' and would be well placed to develop and launch such a system.
Visa International Service Association/Plaid Inc. (2020)[9]	Plaid continuing to invest in and develop its account information services and payment initiation services offering in the UK.	Internal documents showing historic growth, geographic expansion, product enhancements and customer acquisition	The CMA considered that Plaid would continue grow in the UK absent the merger.

5 https://assets.publishing.service.gov.uk/media/5f297aa18fa8f57ac287c118/Final_report_pdf_a_version_-----.pdf

Assessment of the loss of future competition

17. If one of the merger firms is a potential entrant, then the merger will remove any future competition between them.

18. The CMA's assessment of competitive effects from the loss of the future competition between the merger firms is similar to its assessment when the merger firms are existing suppliers, except that the CMA's assessment will reflect the future competitive conditions expected after entry or expansion by the merger firms has taken place.

19. The impact of a potential entrant on competition is likely to be more significant when there are fewer strong existing competitive constraints on the other merger firm; where the other merger firm would already have market power absent the merger (with greater market power being associated with a greater likelihood of an entrant having a bigger impact on competition); and/or where there are few other potential constraints. Where one merger firm has a strong position in the market and there are few significant potential competitors, even small increments in market power may give rise to competition concerns. Therefore, the acquisition by any such firm of a potential entrant may be concerning even if that potential entrant is expected to be small. The CMA will take into account entry or expansion by non-merging rivals over a similar time horizon as the merger firms' entry or expansion.

20. Evidence relevant to the CMA's assessment of the loss of future competition brought about by the merger might include, firms' internal documents, business forecasts or valuation models. The CMA may consider the likely characteristics of the potential entrant's future product or service, in particular any that would make it attractive to customers, for example if it is planning to introduce a disruptive new business model or technology.[10] The CMA may also consider whether the potential entrant has any features that would affect how well-placed it is to enter, such as existing customer relationships from related products that could enable it to cross-sell or bundle them to gain scale quickly.[11] Any commercial responses made by existing firms in anticipation of rival entry may also be indicative of the entrant's expected impact.

2.2.2. Loss of dynamic competition

21. In some sectors, an important aspect of how firms compete involves efforts or investments aimed at protecting or expanding their profits in the future. This includes

[6] https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

[7] https://assets.publishing.service.gov.uk/media/5e3d7c0240f0b6090c63abc8/2020207_-_Roche_Spark_-_non-confidential_Redacted-.pdf

[8] https://www.gov.uk/cma-cases/illumina-inc-pacific-biosciences-of-california-inc-merger-inquiry#provisional-findings

[9] https://assets.publishing.service.gov.uk/media/5f7aede48fa8f55e2c8bc8e3/20201002_-_Visa_Plaid_-_Full_Text_Decision_FINAL_---.pdf

[10] For example, the *Provisional Findings in Experian Limited/Credit Laser Holdings (ClearScore)* state that ClearScore's successful business model resulted in rapid customer acquisition and was adopted by other market participants: https://www.gov.uk/cma-cases/experian-limited-credit-laser-holdings-clearscore#provisional-findings

[11] In *Amazon.com NV Investment Holdings LLC/Roofoods Ltd (Deliveroo)*, the CMA considered that Amazon would be well-placed to be an effective entrant in the online restaurant platform market. This was due, in part, to its unique asset of its Prime customers.

efforts that may give firms the ability to compete in entirely new areas (i.e. to enter), or the ability to compete more effectively in areas where they are already active (i.e. to expand). Examples of the types of efforts or investments firms might make include developing new products or improving existing ones; introducing more efficient or disruptive business models; introducing new features that benefit customers but also increase customer stickiness; or sacrificing short-run margins (or even operating at a loss) in order to attract users to their platform and benefit from network efficiencies, to achieve a minimum efficient scale, to scale up a distribution network, or to establish a reputation.

22. Where investment and innovation efforts represent an important part of the competitive process itself, this can lead to dynamic competitive interactions between existing competitors and potential entrants that are making efforts to enter or expand (i.e., dynamic competitors). Existing firms may invest in the present in order to protect future sales from dynamic competitors. Dynamic competitors making investments in the present will do so in order to win new sales in the future, including by winning sales from other suppliers.

23. Mergers can reduce the dynamic competitive interactions between an existing supplier and a dynamic competitor, or between two dynamic competitors:[12]

a. A merger involving an existing supplier and a dynamic competitor may lead the existing supplier to reduce its efforts in the present to protect against the possible impact of the dynamic competitor, as any future loss of sales to the dynamic competitor would not reduce the profits of the merged entity.

b. A merger involving a dynamic competitor making efforts towards entry or expansion may lead the merged entity to reduce those efforts. After a merger, any profits that the dynamic competitor would expect to 'steal' from the other merger firm would no longer contribute to an incentive to enter, as these profits would already be captured by the merged entity.

24. There may be some uncertainty about the outcome of investments and innovation efforts absent the merger, including whether the investments being made by merger firms would ultimately result in products or services being made available to customers. However, uncertainty about the outcome of a dynamic competitive process does not preclude the CMA from assessing the impact of the merger on that dynamic process.[13] A process of dynamic competition can increase the likelihood of new innovations or products being made available, and therefore has economic value in the present.

25. Accordingly, while the CMA's assessment of dynamic competition may, in some cases, focus on entry and expansion in relation to specific products, in others, it may

[12] Antitrust and Innovation: Welcoming and Protecting Disruption, by Carol Shapiro, Giulio Federico, and Fiona Scott Morton. Innovation Policy and the Economy, Volume 20 and Ioannis K, Valletti T, 2020, Innovation considerations in horizontal merger control, *Journal of Competition Law and Economics,* Vol: 16, Pages: 220- 261, ISSN: 1744-6414.

[13] For example, the CMA considered the impact of uncertainty on the assessment of dynamic competition in its *Provisional Findings in Illumina Inc/Pacific Biosciences of California Inc*. In particular the CMA's provisional view was that the market was dynamic and that the competitive overlap and closeness of competition between the parties was likely to increase in the future as R&D was devoted to improving each party's technology to address a wider range of use cases, applications and/or projects. The CMA provisionally concluded this despite uncertainty regarding the precise timing and level of convergence of the parties' products, how successful PacBio's new model of sequencer would be, and when, and if, Illumina would have launched a commercial 'long read' system absent the merger.

consider a broader pattern of dynamic competition in which the specific overlaps may not be identified easily at the point in time of the CMA's assessment. Examples might include two digital platforms exhibiting a pattern of using their existing platforms or suites of integrated services as a launchpad to enter into new, overlapping services; two pharmaceutical companies engaging in research programmes that are likely to treat the same illnesses;[14] or two firms with geographic expansion strategies that are likely to target similar local areas.[15] Where this is the case, the CMA may assess a broader loss of competition arising from a reduction in the merger firms' incentives to continue investing in these competing programmes or strategies, rather than focusing on individual future overlaps.[16]

26. When assessing losses of dynamic competition, the CMA may consider evidence on any direct response of an incumbent merger firm to the threat of entry or expansion by the other merger firm or may consider evidence on the incumbent's incentive to respond to any such threat.

27. The likelihood of successful entry by a dynamic competitor and the expected closeness of competition between a dynamic competitor and other firms are both relevant to the constraint exerted by a dynamic competitor on other firms and the CMA will take this into account. The elimination of a dynamic competitor that is making efforts towards entry or expansion may lead to a substantial lessening of competition even where entry by that entrant is unlikely and may ultimately be unsuccessful. This may be the case if, for example, there is evidence that the competitor's entry or expansion would have a significant impact on other firms' future profits. In such circumstances, the removal of the threat of entry may lead to a significant reduction in innovation or efforts by other firms to protect those future profits.

28. Firms may use different levers to respond to dynamic competition. For example, firms may be more likely to flex their prices (which may be changed rapidly in the short-run) in response to competition from existing competitors, while using investment and innovation efforts to protect their profits from long-run, dynamic threats from potential entrants. Therefore, competition concerns may arise in relation to losses of existing competition despite the presence of dynamic constraints from potential entrants. Conversely, a loss of dynamic competition may be significant even though there are sufficient constraints to protect existing competition on aspects of competition that can be flexed in the short-run.

2.3. Entry as a countervailing factor in mergers

29. In some instances, there may be countervailing factors that prevent or mitigate any substantial lessening of competition, and one of them is through the entry and/or expansion of third parties in reaction to the effects of a merger.

[14] For example, *Roche Holdings, Inc./Spark Therapeutics, Inc*.

[15] For example, *Pure Gym Limited/The Gym Limited*: https://assets.publishing.service.gov.uk/media/5411599fed915d12db00000b/Pure_Gym-The_Gym-full_text_decision.pdf_Gym-full_text_decision.pdf.

[16] For example, in *Pure Gym Limited/The Gym Limited*, the CMA found at Phase 1 that in the absence of one of the merger firms, the other may not have the same incentive to maintain policies such as a uniform network-wide price-for-life policy or 24/7 opening. The CMA also found that the merger is likely to materially alter the incentives of the merger firms to expand their networks.

30. In its competitive assessment, the CMA may take into account entry and/or expansion plans of rivals who will enter or expand irrespective of whether the merger proceeds. However, any analysis of a possible substantial lessening of competition includes consideration of the direct responses to the merger by rivals, potential rivals and customers. If effective entry and/or expansion occurs as a result of the merger and any consequent adverse effect (for example, a price rise), the effect of the merger on competition may be mitigated. In these situations, the CMA may conclude than no substantial lessening of competition arises as a result of the merger.

31. The MAGs also set out the CMA's approach to entry and expansion as countervailing measures to what might otherwise be a significant lessening of competition finding. The CMA considers that entry and/or expansion preventing a significant lessening of competition from arising would be rare. The CMA's evaluation of a selection of some of its past cases has shown that in some instances when it has relied on entry or expansion to clear mergers, that entry or expansion did not in fact materialise.[17]

2.3.1. Framework for assessing entry and expansion

32. The CMA will use the following framework to determine whether entry or expansion would prevent a substantial lessening of competition. The entry or expansion must be:

a. timely;

b. likely; and

c. sufficient to prevent a substantial lessening of competition.

33. These conditions are cumulative and must be satisfied simultaneously. If, for example, it is likely that entry by a rival would occur rapidly after a merger, but to achieve sufficient expansion to offset the adverse effects of the merger the rival would need a period of time further in the future (which would not be timely within the context of the markets at issue), then the CMA may conclude that entry and expansion would not prevent a substantial lessening of competition.

Timeliness of entry or expansion

34. The CMA will consider whether the effect on competition and the market will be timely. It is not just a case of entry or expansion occurring in a timely manner but the effectiveness of that entry or expansion on market outcomes must be timely. What is considered to be timely in order to prevent or mitigate the adverse effects of a merger will depend on the industry and the characteristics and dynamics of the market, and the timeframe over which the CMA expects a substantial lessening of competition to result from a merger. Typically, entry or expansion being effective within two years of a substantial lessening of competition arising would be considered by the CMA to be timely although, depending on the nature of the market, the CMA may consider a period of time shorter or longer than this.[18]

[17] KPMG, Entry and expansion in UK merger cases: an ex-post evaluation, April 2017: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/606693/entry-and-expansion-in-uk-ex-post-evaluation-kpmg.pdf

[18] In general, the same standard of evidence, and the relevant time period, of entry or expansion by one of the merger firms in the counterfactual will be applied to entry or expansion by a third party, whether in the CMA's assessment of countervailing factors or in its assessment of the theory of harm(s).

35. Generally, the further out in time that entry or expansion is expected to occur the less certainty the CMA can attach to whether such entry or expansion would occur.

Likelihood of entry or expansion

36. In considering whether any potential rivals will enter or existing rivals will expand in response to a merger, the CMA must be satisfied that the rivals will have both the ability and incentive to do so. The CMA will consider the scale of any barriers to entry and/or expansion. In a market characterised by low barriers to entry and/or expansion, potential entrants may nevertheless be discouraged from entering by the small size of the available market (for example because the market itself is small or declining),[19] or the credible threat of retaliation by incumbents (whether in the same market as the merged entity or another market where that new entrant is already present).[20]

37. The circumstances around potential entry or expansion may fall into three broad categories:

a. A firm with the potential to enter or expand may find it profitable to enter (or expand) at pre-merger prices. In such cases, the CMA might expect to see evidence that the firm was actively planning to enter or expand pre-merger. In such cases, the CMA may assess the impact of such entry as part of its competitive assessment.

b. A firm may only find it profitable to enter or expand if prices remain above pre-merger levels. Such cases of entry or expansion are unlikely to restore pre-merger prices and are unlikely to prevent a substantial lessening of competition from arising.

c. A firm may find that it would be profitable to operate (or add capacity) at pre-merger prices, but nevertheless would not find it profitable to enter or expand because its entry or expansion would push prices down below pre-merger levels. In such cases, a merger that causes prices to rise may introduce the buffer that the firm needs in order be able to enter and expand and subsequently compete at pre-merger prices. Therefore, when considering countervailing entry and expansion, the CMA may be particularly interested in evidence that entrants or incumbents were actively monitoring the opportunity to enter or expand prior to the merger, that such entrants could operate (or expand) profitably at pre-merger prices, and/or that entry or expansion would quickly become attractive if prices were to start rising.

Sufficiency of entry or expansion

38. Entry or expansion should be of sufficient scope and effectiveness to prevent a substantial lessening of competition from arising as a result of the merger. Entry or expansion needs to be successful over a sustained period of time. Sufficiency to constrain

[19] In *Prosafe SE/Floatel International Limited (Provisional Findings)* the CMA found evidence that value of contracts were small relative to the cost of entry for firms operating outside North-West Europe. See https://assets.publishing.service.gov.uk/media/5e32e25ae5274a08e9dc739b/Provisional_findings_Prosafe_-_Floatel_--.pdf.

[20] In *Arriva Rail North/Northern rail franchise*, the CMA considered incumbent's ability to credibly threaten to retaliate against operators seeking to enter their 'core territories'. See https://assets.publishing.service.gov.uk/media/581b6b6ced915d7ad5000007/arriva-northern-final-report.pdf

the merged entity may come from a single entrant or firm expanding or from several, in aggregate.

39. Expansion is unlikely to constrain the merged entity where that expansion results from a rival simply gaining some sales from a merged entity which has raised prices. The CMA may therefore examine evidence as to whether any entry or expansion would increase the competitive constraint that rivals exert on the merged entity, for example by introducing additional capacity, or new or better competitive offerings. The CMA may consider the history and experience of past entry or expansion.

40. Small-scale entry that is not comparable to the constraint eliminated by the merger is unlikely to prevent a substantial lessening of competition. In a differentiated market, entry into a market niche may be possible, but to the extent the niche product may not necessarily compete strongly with other products in the overall market, it may not constrain incumbents effectively.

2.3.2. Barriers to entry and expansion

41. Potential or actual competitors may encounter barriers which reduce or even severely hamper their ability to enter or expand in the market. Barriers to entry and expansion are specific features of the market that give incumbent firms advantages over potential competitors. Barriers to entry and expansion hinder the ability of potential entrants or firms looking to expand to constrain the exercise of market power by incumbents. The CMA will therefore identify barriers to entry and/or expansion in its analysis. Where barriers are low, and the costs of entry or expansion are not substantial relative to the profits that are available, entry and/or expansion might be expected to occur in order to capture sales from the merged entity if it were to increase prices and/or worsen non-price factors of competition. Conversely, this is less likely where barriers are substantial relative to available profits.

42. Often barriers to entry or expansion are related to the nature of the market. While it is not possible to provide a comprehensive list of barriers to entry and expansion (given that such barriers are liable to vary between different sectors and over time), common barriers include:

a. Initial set-up costs and costs associated with investment in specific assets are more likely to deter entry or expansion where a significant proportion of them are sunk.[21]

b. Customers may place a high value on the reputation and track record of suppliers.[22] This might be especially true where the product or service being provided is important for the customer, and where the quality of the product is difficult to ascertain in advance.

[21] i.e. the costs cannot be recovered when exiting from the market. The CMA considered the upfront costs required for entry in *Tobii AB/Smartbox Assistive Technology Limited and Sensory Software International Ltd* (https://assets.publishing.service.gov.uk/media/5d5d1800e5274a0766482c45/Final_Report2.pdf) and its Provisional Findings in *Illumina Inc/Pacific Biosciences of California Inc*.

[22] In *Ecolab Inc/The Holchem Group Limited*, the CMA found that customers had low switching rates and placed value on reputation, reliability and a proven track record. See https://assets.publishing.service.gov.uk/media/5d9ca523ed915d35d0dcca3e/ECOLAB_Final_report.pdf

c. Consumers may demonstrate a high level of brand loyalty, be tied into long contracts or exclusivity agreements, or face other significant switching costs, which may make entry or expansion more difficult and require investment. For example, in some digital markets switching might involve giving up access to an ecosystem of products and services.

d. Economies of scale may be present.[23]These may prevent small-scale entry from acting as an effective competitive constraint in the market. Further, in the presence of economies of scale, large-scale entry or expansion will generally be successful only if it expands the total market significantly, or substantially replaces one or more existing firm; and if the entrant can afford the risk that such investment will involve, especially in terms of sunk costs. Many markets exhibit economies of scale.[24]

e. Network effects.[25] In such circumstances, the need to attract a large number of customers to one or both sides of the entrant's platform in order to be an effective constraint may make sufficient entry and expansion both costly and risky, particularly in the presence of larger incumbents.[26] Many digital markets are characterised by considerable network effects as well as non-digital markets.[27]

f. The technology and production methods used in the market may themselves present barriers to an entrant. For example, intellectual property rights of rivals and interoperability requirements may need to be taken into account by entrants.

g. Early mover advantages. Incumbents may have early mover advantages as a result of branding or creating switching costs. The data held by many digital market firms allow them to hone, improve and personalise their products and services, and this may be difficult for an entrant to replicate in a timely manner.[28] Early mover advantages may be strengthened by the combination of the merger firms.

h. Regulations, licensing arrangements, intellectual property rights and trade barriers may also form considerable barriers to entry.[29]

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[23] These arise where average costs fall as the level of output rises over a range of output volume.

[24] For example, many digital and software markets as well as other markets such as pharmaceutical markets.

[25] See the section on 'Nature of competition' in Chapter 9 of the Merger Assessment Guidelines.

[26] See the Final Report of *Intercontinental Exchange Inc/ Trayport*, in particular paragraphs 7.112-7.170 and 9.4- 9.16 (https://assets.publishing.service.gov.uk/media/58049a0740f0b64fbe000006/ice-trayport-final-report.pdf).

[27] For example, card payment systems.

[28] Early mover advantages are also present in non-digital markets.

[29] For example, in *Bauer Media Group/Celador Entertainment Limited/Lincs FM Group/Wireless Group Limited/UKRD Group Limited* (https://assets.publishing.service.gov.uk/media/5e6a3205d3bf7f269dbeeef5/Bauer_final_report.pdf) the CMA found that the lack of available radio spectrum was a barrier to entry; in *Ladbrokes plc/Gala Coral Group Limited* (https://assets.publishing.service.gov.uk/media/5797818ce5274a27b2000004/ladbrokes-coral-final-report.pdf) planning approval was considered to be a barrier to entry; and in the Provisional Findings *of Illumina Inc/Pacific Biosciences of California Inc* intellectual property rights were provisionally viewed as a barrier to entry.

43. Barriers to entry and expansion might be particularly high if some of these factors are present in combination. For example, an incumbent might have a large cost advantage from its scale and/or data while also benefitting from network effects.

44. Finally, when considering the likelihood of successful entry by third parties, the CMA may consider the strategic behaviour of the merged entity or other incumbents which itself might create or strengthen a barrier to entry or limit the ability of a new entrant to gain a foothold in the market. This might involve strategic, temporary price cuts, entering into exclusive dealing arrangements or long contracts, or otherwise increasing customer stickiness, for example. The merged entity's ability to engage in this behaviour may be increased through the merger.

3. Potential competition in UK antitrust cases

45. Undertakings already on the market, or considering entering, can be expected to take into account the prospect of other undertakings entering, and to adapt their behaviour accordingly. In particular, undertakings may respond by seeking to prevent, delay and/or otherwise inhibit entry by:

a. entering into agreements or engaging in concerted practices with that object or effect, such as market exclusion agreements; and/or

b. where an incumbent holds a dominant position, adopting practices outside the realm of merits-based competition to exclude or inhibit rivals.

46. Where such practices may affect trade within the UK, they are prohibited in UK law. Anti-competitive agreements and concerted practices are prohibited under what is referred to as the Chapter I prohibition of the Competition Act 1998. Abuse of dominance is prohibited under what is referred to as the Chapter II prohibition.

47. The CMA has taken enforcement action against such practices in a number of cases. In recent years we have found that potential competition plays a particularly important role in the pharmaceutical sector. As in many other jurisdictions, in the UK the developers of innovative medicines can secure market exclusivity through patents, enabling them to charge high prices to recoup the costs of research and development and to incentivise ongoing innovation. Once a drug becomes generic, competition is expected to ensure its price falls. The medicines sector is therefore particularly sensitive to a delay in the entry of competitors, which allows for the maintenance of a monopoly price that is ultimately borne by the UK's National Health Service (NHS).

48. The CMA's antitrust cases in this sector illustrate the approach to potential competition in the UK.

3.1. The legal test for potential competition: likelihood, strength and timing of entry

49. In assessing whether an undertaking is a potential competitor, the critical question is whether it has '*real and concrete possibilities*' of entering the market.[30]

50. The application of this test has recently been clarified in the CMA's *Paroxetine* case (discussed below). Following a reference from the UK's Competition Appeal Tribunal

[30] C-591/16 *Lundbeck v Commission*, paragraphs 54-55; T-360/09 *E.ON v Commission*, paragraph 85; T-461/07 *Visa v Commission*, paragraphs 68 and 166; C-307/18 *Generics (UK) v CMA*, paragraph 36; GSK *v CMA* [2018] CAT 4, paragraph 92.

(CAT), in January 2020 the European Court of Justice clarified that an undertaking has real and concrete possibilities of entry where it:

a. 'has in fact a firm intention and an inherent ability to enter the market'; and

b. 'does not meet barriers to entry that are insurmountable'.[31]

51. The CAT issued supplementary judgment in the *Paroxetine* case on 10 May 2021, applying this test.[32]

52. The test is assessed to the civil standard of proof: on the balance of probabilities.

3.1.1. 'A firm intention and an inherent ability to enter the market'

53. The phrase '*a firm intention*' does not require an assessment of the potential entrant's subjective state of mind. Its '*firm intention*' and '*inherent ability to enter*' are established through an objective assessment of its position.[33] Where the potential entrant has taken sufficient preparatory steps to enable it to enter the market concerned within such a period of time as would impose competitive pressure on the incumbent, it has a firm intention and an inherent ability to enter the market.[34]

54. In the pharmaceutical industry such steps may, for example, include measures to obtain the necessary licences (where applicable) and/or stock; legal steps to challenge the incumbent's patents (where applicable); and/or initiatives by the potential entrant to market its product.[35]

55. There is no requirement that an undertaking have taken any or all of these particular steps. For example, an undertaking may be a potential competitor before it has obtained a necessary licence[36] and before it has obtained saleable finished product.[37] The activities of undertakings seeking to obtain the necessary licences or to take the necessary administrative and commercial steps to enter are themselves an expression of potential competition.[38] An undertaking may have multiple potential routes to market and it is not necessary to show which is most feasible or likely.[39] There is also no requirement to demonstrate that the undertaking would in fact have entered or been capable of retaining

[31] C-307/18 *Generics (UK) v CMA*, paragraphs 36-37 and 58. See also C-591/16 *Lundbeck v Commission*, paragraphs 55-56.

[32] *GSK v CMA* [2021] CAT 9.

[33] T-461/07 *Visa v Commission*, paragraph 168; *GSK v CMA* [2018] CAT 4, paragraph 92. See also C-591/16 *Lundbeck v Commission*, paragraph 74.

[34] C-307/18 *Generics (UK) v CMA*, paragraphs 43-44. See also *GSK v CMA* [2021] CAT 9, paragraphs 11-12; C-591/16 *Lundbeck v Commission*, paragraphs 55-57.

[35] C-307/18 *Generics (UK) v CMA*, paragraph 44; *GSK v CMA* [2021] CAT 9, paragraph 13.

[36] *GSK v CMA* [2018] CAT 4, paragraph 158, citing T-472/13 *Lundbeck v Commission*, paragraph 171 (upheld in C-591/16 *Lundbeck v Commission*, paragraph 83).

[37] T-472/13 *Lundbeck v Commission*, paragraphs 308-310 and 321-322. See also C-586/16 *Sun Pharmaceuticals and Ranbaxy v Commission*, paragraph 44.

[38] T-472/13 *Lundbeck v Commission*, paragraph 171; upheld in C-591/16 *Lundbeck v Commission*, paragraph 87.

[39] T-472/13 *Lundbeck v Commission*, paragraphs 204 and 320-322.

its place on the market if it did – such a requirement would deny any distinction between potential and actual competition.[40]

56. A competitive relationship between undertakings can be confirmed by additional factors (which are not in themselves sufficient).[41]

57. Because the test turns on whether the potential entrant was capable of imposing competitive pressure on the incumbent, the incumbent's perception of the competitive threat that a potential entrant poses, and its reaction to that threat, are relevant.[42] If an undertaking is perceived as a potential entrant to the market, it may, simply by its existence, impose competitive pressure on the incumbent.[43]

58. The conclusion of an agreement between undertakings at the same level of the production chain is a strong indication that a competitive relationship exists between them.[44] In particular, an agreement to transfer value (by way of payments in cash or in kind) from an incumbent to a potential entrant in exchange for postponing its entry provides an indication of the incumbent's perception of the commercial threat that potential entrant poses and therefore of a competitive relationship between them. The greater the transfer of value, the stronger the indication.[45]

59. The analysis should be conducted principally on contemporaneous evidence. However, although subsequent evidence is not decisive, it can be taken into account to the extent that it is capable of clarifying the parties' positions at the relevant time.[46]

3.1.2. No insurmountable barriers to entry

60. Whereas barriers to entry generally include factors that inhibit or disincentivise entry, when assessing whether an undertaking is a potential competitor the focus is on barriers that prevent entry outright. Because the threshold for potential competition ('*real and concrete possibilities*' of entry) is low, the threshold for a barrier that prevents a finding of potential competition is high: barriers must be '*insurmountable*', eliminating all possibilities of entry.[47] Regulatory and manufacturing hurdles to obtaining licences and market-ready stock are not the same as insurmountable barriers.

61. In the pharmaceutical sector especially, the patent regime is often invoked by the parties as a factor that precludes a finding of potential competition. However, the fact that an incumbent holds a patent does not mean potential entrants face an insurmountable barrier to entry. Potential competition may exist before the patent expires, since

[40] C-307/18 *Generics (UK) v CMA*, paragraph 38; T-472/13 *Lundbeck v Commission*, paragraph 159, upheld in C-591/16 *Lundbeck v Commission*, paragraph 63.

[41] C-307/18 *Generics (UK) v CMA*, paragraph 54.

[42] C-307/18 *Generics (UK) and others v CMA*, paragraphs 42 and 57. See also C-591/16 *Lundbeck v Commission*, paragraphs 74-76.

[43] C-307/18 *Generics (UK) and others v CMA*, paragraph 42.

[44] C-307/18 *Generics (UK) and others v CMA*, paragraph 55. See also C-373/14 *Toshiba v Commission* EU:C:2016:26, paragraph 33; C-591/16 *Lundbeck v Commission*, paragraph 57; and *GSK v CMA* [2021] CAT 9, paragraph 14.

[45] C-307/18 *Generics (UK) and others v CMA*, paragraph 56.

[46] T-472/13 *Lundbeck v Commission*, paragraphs 138 and 141, upheld in C-591/16 *Lundbeck v Commission*, paragraphs 66-72.

[47] Compare C-373/14 *Toshiba v Commission*, paragraphs 31-34.

undertakings can be expected to prepare to enter the market in advance. In any event, while a patent is presumed to be valid, that does not mean that entry while the patent exists is presumed to be unlawful. Undertakings may seek to enter 'at risk' of the incumbent suing for patent infringement, and/or intend to challenge the patent's validity. Even where undertakings are not prepared to enter until the validity of the patent has been determined in court, they may still be potential competitors.[48]

62. Where a potential entrant makes preparations to enter, this may result in a dispute with the incumbent about the scope and validity of the patent. Far from precluding potential competition between the parties, such a dispute is in fact evidence of a potential competitive relationship between them.[49] Further, where such a dispute results in an interim measure such as an injunction or undertaking that temporarily prohibits entry pending resolution of the dispute, this also does not preclude a finding of potential competition.[50]

63. Potential entrants may face other regulatory hurdles. For example, in the pharmaceutical sector regulation may restrict the indications (therapeutic uses) that may be specified on suppliers' licences. Suppliers of drugs without those indications may nonetheless exert a competitive constraint through the potential for dispensing 'off-label': where a drug is dispensed to treat a condition not specified on its licence. The European Court of Justice has held that such 'off-label' use '*reveals the existence of a specific relationship of substitutability*' between products.[51] Whether such substitutability leads to a competitive relationship between the products will depend on the facts.

3.1.3. The timeframe for potential entry

64. Because the test depends on whether the potential entrant was capable of entry within such a period of time as to impose competitive pressure on the incumbent, there is no specific timeframe within which the potential entrant must have real and concrete possibilities of entry; each case turns on its facts.[52]

65. In the case of an agreement, it is in particular not necessary to prove that the potential entrant would have entered the market before the expiry of the agreement in order to establish the existence of potential competition.[53]

3.2. CMA case studies

3.2.1. Agreements and concerted practices between potential competitors

66. For an agreement or concerted practice between undertakings at the same level of the production or distribution chain to be anti-competitive, the parties must at least be

[48] C-591/16 *Lundbeck v Commission*, paragraphs 58-61. See, for example, *GSK v CMA* [2018] CAT 4, paragraphs 96-132.

[49] C-307/18 *Generics (UK) and others v CMA*, paragraphs 52 and 100; *GSK v CMA* [2021] CAT 9, paragraph 17.

[50] *GSK v CMA* [2018] CAT 4, paragraphs 140-143 and 156.

[51] C-179/16 *Hoffmann-La Roche v Commission*, paragraphs 61 and 64-67.

[52] T-472/13 *Lundbeck v Commission* EU:T:2016:449, paragraph 163 (upheld in C-591/16 *Lundbeck v Commission*).

[53] T-472/13 *Lundbeck v Commission*, paragraph 163 (upheld in C-591/16 *Lundbeck v Commission*).

potential competitors at the time, since otherwise their collusion is not capable of harming competition.[54]

67. The CMA has therefore assessed whether the parties have real and concrete possibilities of entry at the time of their collusion in each of the cases in which it has found a horizontal anti-competitive agreement or concerted practice.

Paroxetine

68. In *Paroxetine*[55] the incumbent supplier of the drug, GSK, entered into agreements with two suppliers seeking to enter the market with generic versions, Alpharma and GUK, to settle disputes over GSK's patents. GSK paid each supplier and they each agreed not to enter the market with their own products.

69. The CMA found that Alpharma and GUK were each potential competitors of GSK when they entered into the agreements in that each had real and concrete possibilities of entering the market:

a. They had committed significant time and resources to developing the capabilities to launch. They had obtained licences and stocks of raw material or even finished product;[56]

b. The patent dispute with GSK (including interim injunctions and undertakings that temporarily prevented their entry) did not create an insurmountable barrier to entry;[57] and

c. The fact that GSK was willing to make substantial value transfers to them in return for their agreement not to enter the market was a strong indication that GSK perceived them as a credible threat and that they exerted competitive pressure on GSK. Consistently with the test outlined above, this was an additional (and important) factor that confirmed the CMA's findings of a potential competitive relationship between GSK and the potential entrants.[58]

70. The CMA also considered the parties' internal documents, which confirmed the conclusions above: in particular, that there was genuine uncertainty about the outcome of the patent dispute at the time of the agreements.[59]

71. The CMA's findings were upheld on appeal.[60]

[54] C-307/18 *Generics (UK) v CMA*, paragraphs 31-32.

[55] https://assets.publishing.service.gov.uk/media/57aaf65be5274a0f6c000054/ce9531-11-paroxetine-decision.pdf

[56] CMA *Paroxetine* decision, paragraphs 6.49-6.51 and 6.67-6.69.

[57] CMA *Paroxetine* decision, paragraphs 6.52-6.55 and 6.70-6.74.

[58] CMA *Paroxetine* decision, paragraphs 6.56-6.60 and 6.75-6.78.

[59] CMA *Paroxetine* decision, paragraphs 6.61-6.64 and 6.79-6.82 and Annexes E and G.

[60] *GSK v CMA* [2021] CAT 9.

Nortriptyline

72. In *Nortriptyline*[61] the CMA found that three undertakings, King, Lexon and Alissa, engaged in a concerted practice by sharing commercially sensitive information about prices, volumes and entry plans to try to keep nortriptyline prices up.

73. Lexon and King were actual competitors: they were both active in the supply of nortriptyline.[62]

74. Alissa was found to be a potential competitor to each of the other two when it engaged in the information exchange on the basis that it had real and concrete possibilities of entering the market:

a. It had obtained licences for nortriptyline and a source of product through a third-party development partner; and

b. It faced no insurmountable barriers to entry. Notwithstanding the fact that its development partner encountered some technical difficulties and delays in getting the product to market, it had the ability to enter with sufficient speed to constrain the other undertakings.[63]

75. Once it started to supply its nortriptyline on the market, Alissa became an actual competitor.[64]

76. The CMA's findings were upheld on appeal.[65]

Fludrocortisone

77. In *Fludrocortisone* the CMA found that three undertakings, Amilco, Tiofarma and Aspen, entered into an agreement in which Amilco and Tiofarma agreed to stay out of the fludrocortisone market so that Aspen could remain the sole supplier, in exchange for a profit share (Amilco) and the right to be sole manufacturer of the drug (Tiofarma). That agreement had the object of preventing, restricting and/or distorting competition.

78. The CMA found that Amilco and Tiofarma, working together, were potential competitors to Aspen. In making this finding the CMA drew in particular on the European General Court's judgment in *Mylan*, in which the Court found that an undertaking can be a potential competitor through the possibility of entering with a business partner.[66] A combined assessment of potential competition may be carried out where two undertakings take joint steps to enter the market on the basis of a partnership. In those circumstances both undertakings can be considered potential competitors of the incumbent.

79. The CMA considered Amilco and Tiofarma together because they used their complementary skills, assets and expertise to pose a competitive threat to Aspen jointly. Amilco had expertise in commercialising drugs, but no regulatory capability to hold an MA

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[61] https://assets.publishing.service.gov.uk/media/5ef469bcd3bf7f7142efc039/Information_Exchange_Decision.pdf

[62] CMA *Nortriptyline* decision, paragraph 5.33.

[63] CMA *Nortriptyline information exchange* decision, paragraph 5.34.

[64] CMA *Nortriptyline information exchange* decision, paragraph 5.35.

[65] *Lexon (UK) Ltd v CMA* [2021] CAT 5.

[66] T-682/14 *Mylan v Commission*, paragraphs 87-88 and 91 and the case cited. See also T-461/07 *Visa v Commission*, paragraphs 82-83, and T-472/13 *Lundbeck v Commission*, paragraphs 197 and 204.

or manufacture drugs. Tiofarma had that regulatory and manufacturing capability but had no expertise in commercialising drugs. The parties were therefore mutually dependent. They had a long-standing business partnership for commercialising medicines, based on mutual trust. They worked together to develop fludrocortisone throughout all stages of the process and took joint steps to commercialise the product, until entering into the agreement.[67]

80. The CMA therefore found that Amilco and Tiofarma were potential competitors to Aspen when they entered into the agreement on the basis that they had real and concrete possibilities of entering the market together:

a. They had together made substantial investments in developing and preparing to commercialise the product, including obtaining the relevant licence (which in itself posed a significant competitive threat to Aspen, whoever brought the product to market), developing a generic version of the drug and manufacturing stock equivalent to nine months of forecast supply volumes;[68]

b. Their combined assets and expertise meant that they had various viable routes to market, whether they maintained control over all steps in the supply chain or outsourced functions to third parties;[69]

c. They faced no insurmountable barriers to entry: there were no legal barriers precluding their entry;[70] and

d. Aspen perceived Amilco and Tiofarma to be a competitive threat, as illustrated by the fact that it entered into an agreement with them under which it committed to sharing a significant proportion of profits in a market in which it was the sole supplier: in itself a strong indication that a competitive relationship existed between them.[71]

Cleanroom laundry services

81. The CMA's *Cleanroom laundry services*[72] decision illustrates that potential competition can also have a geographic dimension and that anti-competitive agreements need not involve incumbents seeking to buy off entry into their own markets.

82. Two suppliers of cleanroom laundry services had a long-running joint venture in which they shared knowhow and operated under a shared brand. They entered into further agreements in which they allocated territories and customers between themselves: the parties drew a line from London to Anglesey and agreed not to compete with one another on either side of that line (with certain exceptions).

83. The CMA found that the undertakings were actual (or at the very least potential) competitors when they entered into the relevant agreements. As suppliers already active on the market and in each other's allocated territories at the time of the agreements, the parties

[67] CMA *Fludrocortisone* decision, paragraphs 8.56-8.58.

[68] CMA *Fludrocortisone* decision, paragraphs 8.59-8.63, 8.75-8.82 and 8.90-8.92.

[69] CMA *Fludrocortisone* decision, paragraphs 8.64-8.74.

[70] CMA *Fludrocortisone* decision, paragraphs 8.84-8.85.

[71] CMA *Fludrocortisone* decision, paragraphs 8.86-8.89.

[72] https://assets.publishing.service.gov.uk/media/5a7c1830ed915d210ade18c9/case_50283_decision.pdf.

were actual competitors. Further, they each had real and concrete possibilities of competing in the other's territory:

a. In the absence of the agreements (which in themselves provided a strong indication that a competitive relationship existed between them), the parties would have been able to compete for the business of customers supplied by the other party in its territory;

b. The parties faced no insurmountable barriers: each held a licence to use the requisite trademarks; and

c. The parties perceived each other as actual or potential competitors and understood that it was only their agreements that prevented them from competing.[73]

3.2.2. Exclusion of potential competitors

84. Many of the cases of exclusionary conduct pursued by the CMA and its predecessor the Office of Fair Trading (OFT) concerned the exclusion of actual, rather than potential, competitors.[74]

85. However, more recent CMA cases provide some insight into assessing potential competition in the context of exclusionary conduct.

Paroxetine

86. In *Paroxetine* the CMA also found that GSK's conduct in making value transfers to GUK and Alpharma to induce them to delay their potential entry to the market independently was an abuse of GSK's dominant position.[75]

87. The CMA's findings applied not only to GSK's agreements with Alpharma and GUK, but also to its agreement with a third undertaking, IVAX. That agreement was excluded from the Chapter I prohibition by a historic exclusion order. The CMA found that IVAX was a potential competitor when it entered into the agreement on the basis that it had real and concrete possibilities of entering the market:

a. It had committed significant time and resources in taking steps to enable it to supply paroxetine, whether through launching its own product or by sourcing from third parties. IVAX did not yet have its own licence in the UK but had the options of using its Irish licence as a basis to obtain one and/or of launching under an MA purchased from a third party;[76]

b. It faced no insurmountable barriers to entry; and

c. The fact that GSK was willing to make substantial value transfers to IVAX was a strong indication that GSK perceived it as a credible threat and that IVAX exerted competitive pressure on GSK.[77]

[73] CMA *Cleanroom laundry services* decision, paragraphs 5.38-5.44.

[74] See, for example, CMA decisions in *Napp*, *Genzyme* and *Cardiff Bus*.

[75] CMA *Paroxetine* decision, paragraphs 8.1-8.75.

[76] CMA *Paroxetine* decision, paragraphs B.4-B.45.

[77] CMA *Paroxetine* decision, paragraphs B.46-B.48.

88. The CMA also had regard, as an additional factor, to the parties' internal documents and witness evidence, which confirmed the conclusions from the evidence above: in particular, that there was genuine uncertainty about the outcome of any patent dispute.[78]

89. The CMA's findings were upheld on appeal.[79]

Remicade

90. In cases of exclusionary abuse, parties often argue for an 'as-efficient competitor (AEC) test': parties argue that competition law should protect the process of competition rather than individual competitors, and therefore that a practice that excludes competitors less efficient than the dominant undertaking should not be an abuse.

91. However, while such a test can be informative, it is not required in all cases and does not provide a 'safe harbour'.[80] The CMA considered this point in its *Remicade* case.

92. Between December 2015 and March 2019, the CMA investigated a discount scheme introduced by Merck, Sharp & Dohme Limited (MSD) in relation to its drug Remicade (MSD's branded version of the drug infliximab, used to treat autoimmune inflammatory disorders such as Crohn's disease and rheumatoid arthritis). The CMA's concern was that the discount scheme – a system of graduated discounts with the discount that MSD granted corresponding to the proportion of total infliximab demand that the NHS purchased through Remicade – had the potential to induce the NHS to remain loyal to Remicade and to make it harder to switch to existing and potential suppliers of 'biosimilar' alternatives of infliximab, thereby producing an exclusionary effect by making entry more difficult. If the NHS switched purchases of Remicade to competing products, it risked the price of Remicade increasing for all future purchases of Remicade.

93. However, on the facts the CMA found that the discount scheme was based on incorrect assumptions that meant it was not likely to have the effect that MSD intended. In March 2019, the CMA issued a decision finding that although MSD's discount scheme was designed to limit or delay the entry or expansion of competing medicines, it was not in fact likely to produce an exclusionary effect. The CMA therefore found no grounds for enforcement action under the Chapter II prohibition.[81]

94. Although the CMA ultimately found no grounds for action, it also explained why it did not apply an AEC test in this particular case. One of the reasons was that the CMA considered that an AEC test may set too high a threshold for finding a discount to be an abuse, and therefore create a risk of under enforcement.[82] In particular:

a. Whereas an AEC test asks whether it is *impossible* for an as-efficient competitor to compete profitably, the law requires only that the practice is likely to make it *very difficult* for a competitor to compete. It is not necessary to show that a practice is

[78] CMA *Paroxetine* decision, paragraphs B.49-B.60.

[79] *GSK v CMA* [2021] CAT 9.

[80] This has recently been confirmed by a May 2021 judgment of the UK Court of Appeal: *Royal Mail plc v OFCOM* [2021] WLR (D) 266. See in particular paragraphs 37-41, 68-70 and 82-89.

[81] https://assets.publishing.service.gov.uk/media/5c8a353bed915d5c071e1588/Remicade_No_Grounds_For_Action_decision_PDF_A.pdf

[82] The CMA's other reasons were that: an AEC test is not the only way in which a discount can be assessed and it is necessary to consider all the relevant circumstances; and the results of an AEC assessment need to be interpreted with caution, particularly where there is uncertainty over how a discount is interpreted by customers.

likely to lead to total exclusion of all existing and potential competitors, only that it is likely to produce an exclusionary effect.

b. Placing a significant burden on entry may make it very difficult for a competitor to compete, particularly in the context of newly emerging and nascent entry and where the prior situation was one of a monopoly supplier.

c. Predation-type tests such as an AEC test may not be appropriate where the dominant company can use a discount to *profitably* exclude actual or potential competitors, particularly where the dominant company can implement a discount over a prolonged period without making losses.

95. The CMA therefore emphasised the importance of assessing the practice in its full context, including that of customers' views and behaviour, without undue regard to hypothetical tests.[83]

4. Conclusion

96. The CMA's mergers and antitrust enforcement experience has given it the opportunity to consider how to address potential competition issues on a number of occasions.

97. In the area of mergers, the revised MAGs set out the CMA's approach to assessing whether a merger involving a potential entrant will lessen competition due to:

a. a loss of the future competition between the merger firms after the potential entrant would have entered or expanded (a loss of future competition); and

b. a loss of dynamic competition between an existing firm and a potential competitor (a loss of dynamic competition).

98. The MAGs set out the factors which the CMA considers when assessing mergers involving a potential entrant, such as the likelihood of entry, the closeness of competition post entry and the current constraint on an incumbent from a potential entrant. They also set out the types of evidence the CMA is likely to assess. The MAGs further set out the CMA's approach to entry and expansion as countervailing measures and its approach to considering barriers to entry and expansion.

99. In its antitrust work, the CMA has taken enforcement action against anticompetitive practices that have excluded or inhibited rivals, most notably in the pharmaceutical sector. These cases have illustrated and helped develop the CMA's approach to considering potential competition.

[83] CMA *Remicade* decision, paragraphs 4.80-4.84.