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Merger Control in Dynamic Markets

- Contribution from the United Kingdom –

1. Introduction

1. This paper sets out the submission made by the Competition and Markets Authority (CMA) on its approach to the assessment of mergers in dynamic markets.
2. The CMA paper starts with a brief overview of some of the common characteristics of dynamic markets. While there is no fixed approach for assessing mergers in dynamic markets, the paper sets out the CMA's approach in recent mergers in this area, examining the CMA's jurisdictional and substantive tools, sources of evidence, and appropriate remedies, based on previous cases. The paper concludes with a brief discussion on whether existing merger control tools are likely to be sufficient to ensure that merger control is able to continue to adequately protect consumers in dynamic markets in the future.

2. Typical features of dynamic markets

3. Dynamic markets are not uniform and can present a variety of different characteristics, depending on the sector, the market dynamics and the relevant market participants. Dynamic markets are typically characterised by ongoing product or process innovation that disrupts existing business models and/or creates new markets. Therefore, in dynamic markets, competition typically revolves around bringing more innovative products or product features to market. The potential effects of a merger in relation to innovation and product development are generally liable to be more important than price effects, particularly in digital markets such as social media where the product has no price for the users and where revenue is generated through advertising and data analytics.
4. Dynamic markets are often distinguished by rapid growth and frequent change of the competitive landscape. Some dynamic markets may have higher rates of entry and exit, although that is not always the case, as some dynamic markets can have high barriers to entry. There may also be frequent technological and commercial developments, with innovations altering the way in which consumers and suppliers interact in the marketplace. Competition in dynamic markets often manifests through rivalry in research, development and innovation, which may be reflected in high investment in research and development (R&D).
5. In dynamic markets, static assessments of market shares and concentration may be less informative of the impact of a merger. Competitors with relatively small market shares may have a disproportionate impact on competition due to their disruptive business model or innovative products. Historic evidence, such as tender or win/loss data, may also not capture the full extent of competition between the merging parties. A forward-looking analysis, considering the merging parties' and their competitors' strategies and plans for future development, may be necessary to fully understand the competitive dynamics of the market.

6. Digital and technology markets are often characterised by high levels of product development and innovation. However, many non-digital industries, such as pharmaceutical and agrochemical markets, may also exhibit dynamic features. The CMA takes into account the particular features of the relevant market when carrying out its competitive assessment of the merger.

3. Challenges for effective merger control in dynamic markets

7. A number of recently published papers from around the world, including the European Commission’s digital experts report in the EU,¹ and the Stigler Center report in the US,² examine the nature of competition in dynamic markets and raise important questions or make recommendations on the appropriate approach to merger control in the digital area.

8. In the UK, there have been two recent studies on competition in digital markets: the Furman Review³ and the Lear Report⁴. Although both reports focus on digital markets, they cover issues that are relevant to the assessment of mergers in dynamic markets more generally.

3.1. The Furman Review

9. In the UK, the Digital Competition Expert Panel (the Panel), chaired by Professor Jason Furman, was appointed by the Government to make recommendations on changes to competition policy to help unlock the opportunities of the digital economy. The Panel’s report covered various aspects of the UK competition and regulatory framework, including merger control and antitrust enforcement. One of the key areas for examination was the appropriate approach to mergers in digital markets. The final report was published in March 2019.

10. The Panel noted that the digital economy is creating substantial benefits for consumers and businesses. While concentration in digital markets can have benefits, it can also give rise to substantial costs. For example, it may impede innovation as new entrants may be disincentivised from bringing new products to the market, and larger incumbents may face little competitive constraint from the threat of new entrants. This creates a trade-off whereby the potential dynamic costs of concentration outweigh any static benefits. The Panel also concluded that competition for the market cannot be counted on, by itself, to solve the problems associated with market tipping and “winner-takes-most”.

¹ Crémer et al., Competition policy for the digital era (April 2019): <https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf>

² Stigler Center for the Study of the Economy and the State, Report of the Committee for the Study of Digital Platforms (May 2019): <https://research.chicagobooth.edu/stigler/media/news/committee-on-digital-platforms-final-report>

³ Report of the Digital Competition Expert Panel, Unlocking digital competition (March 2019): <https://www.gov.uk/government/publications/unlocking-digital-competition-report-of-the-digital-competition-expert-panel>

⁴ Lear, Ex-post Assessment of Merger Control Decisions in Digital Markets (June 2019): <https://www.gov.uk/government/publications/assessment-of-merger-control-decisions-in-digital-markets>

11. The Panel identified a number of areas where digital markets pose new challenges to competition. Digital markets typically have a number of features which mean they often lean towards concentration, with limited degree of in-market competition. For example, barriers to entry are common due to the accumulation of data by the incumbent firms. Moreover, the Panel identified a number of practical challenges for the analytical tools used by competition authorities such as the CMA.

12. In relation to merger policy, the Panel noted the possibility of underenforcement in digital markets. The Panel considered that updating merger policy to ensure the correct application of economic analysis would result in more merger enforcement. The Panel suggested that there had previously been limited scrutiny of acquisitions by the major digital platforms and, in particular, that no acquisition had previously been blocked. The Panel considered that this suggests that previous practice has not had any “false positives”, that is blocking mergers that should have been allowed, while it may have had “false negatives”, i.e. approving mergers that should not have been allowed.

13. The Panel made a strategic recommendation for a reset for merger assessment in digital markets. According to the Panel, the CMA should take more frequent and firmer action to challenge mergers that could be detrimental to consumer welfare due to loss of future innovation and competition, supported by changes to legislation where necessary. Further to this strategic recommendation in relation to mergers more generally, the Panel also made a number of key recommendations for digital mergers specifically:

- First, the CMA should select more digital market cases for examination and consider harm to innovation and impact on potential competition in its assessment of such cases.
- Second, digital companies that have been designated with a strategic market status⁵ should be required to make the CMA aware of all intended acquisitions. As the CMA’s regime is voluntary, the Panel noted that requiring these companies to make the CMA aware of their intended actions would allow the CMA to determine which cases warrant more detailed scrutiny in a timely manner.
- Third, the CMA should update its substantive Merger Assessment Guidelines in order to enable a more effective review of mergers in the digital sector – with some specific suggestions for change for this purpose.⁶

⁵ Strategic market status refers to a position of a company allowing it to exercise market power over a gateway or bottleneck in a digital market, where it controls other’s market access.

⁶ The suggestions of the Panel include the following: enhanced treatment of multisided platform markets; highlighting the relevance of data assets in digital market competition; discussing the nature of competition in platform markets with zero monetary price to consumers; including explicit references to loss of future innovation; placing greater emphasis on the loss of future potential competition; toning down the existing text that suggests that non-horizontal mergers will typically be benign; drawing attention to the evidential relevance of the transaction value relative to the market value and company turnover; highlighting that evidence on the behaviour of an acquiring firm following previous mergers may be pertinent to assessing that firm’s acquisition strategy; clarifying that the substantiality of a lessening of competition may depend on the extent of competition pre-merger; confirming that the UK merger test will address situations in which a merger gives rise to the “creation or strengthening of a dominant position”, so long as it generates a significant lessening of competition; emphasising that empirical evidence should always be considered within the context of an economic framework that takes into account underlying economic theory and principles, which can allow certain inferences to be made; and highlighting that when considering potential pro-

- Fourth, a fundamental re-design of the statutory test used in merger control. This includes the adoption of a so-called “balance of harms” test under which both the likelihood and the magnitude of the impact of the merger would be considered, and mergers would be blocked when they are expected “to do more harm than good”.

3.2. The Lear Report

14. The CMA commissioned the economic consultancy Lear to carry out an *ex-post* evaluation of merger decisions in the digital sector. The objectives of the study were: (a) to review the relevant economic literature and theories of harm typically pursued by competition authorities in relation to digital mergers; (b) to assess previous decisions by the CMA’s predecessor organisations,⁷ and evaluate whether these decisions were reasonable, based on the evidence available at the time; and (c) to evaluate the market evolution following these mergers to ascertain whether they have led to a detrimental outcome. Lear published its final report (the Lear Report or Report) in May 2019.

15. The Lear Report identified that certain companies active in digital markets are also particularly active in M&A activity. For example, the Report noted that between 2008 and 2018, Google acquired 168, Facebook 71, and Amazon 60 companies. None of these acquisitions were blocked and relatively few were subject to scrutiny from competition authorities.

16. The Lear Report also analysed the age of the targets at the time of their acquisition and found that the targets were four-years-old or younger in nearly 60% of cases. More specifically, the median age of Amazon’s targets was 6.5, Facebook’s 2.5, and Google’s 4 years. The Lear Report suggested that the implication for competition authorities is that there can be considerable difficulties in understanding the competitive implications of the acquisition of a ‘young’ firm. This is because it can be very difficult to determine if the young firm will grow to become a significant competitive force.

17. The Lear Report closely examined previous merger decisions, including *Facebook/Instagram*,⁸ *Google/Waze*⁹ and *Expedia/Trivago*,¹⁰ to understand which theories of harm typically have been pursued in digital mergers and how the relevant economic features of digital markets have been taken into account. The Lear Report expressed a concern that merger policy has put too much weight on the risk of incorrect intervention compared to the risk of incorrect clearance when assessing mergers in the digital sector, leading to increased concentration in digital markets. The Lear Report considered that the

competitive effects of the merger, it may be appropriate to consider whether the same benefits could be delivered through acquisition by purchasers that raise fewer competition concerns. Report of the Digital Competition Expert Panel, *Unlocking digital competition* (March 2019), Box 3A: <https://www.gov.uk/government/publications/unlocking-digital-competition-report-of-the-digital-competition-expert-panel>

⁷ The Office of Fair Trading (OFT) and the Competition Commission (CC).

⁸ See case page for the *Facebook/Instagram* merger: <https://www.gov.uk/cma-cases/facebook-instagram-inc>

⁹ See case page for the *Google/Waze* merger: <https://www.gov.uk/cma-cases/motorola-mobility-holding-waze-mobile-ltd>

¹⁰ See case page for the *Expedia/Trivago* merger: <https://www.gov.uk/cma-cases/expedia-inc-trivago-gmbh>

nature of competition in many digital markets may change the terms of the usual trade-off between underenforcement and overenforcement.

18. Mergers may prevent the development of competitors in two main ways: (a) directly, when the incumbent of a digital market acquires an entity that is an actual or potential competitor; and (b) indirectly, when the incumbent acquires an entity that supplies a complementary product / service thereby depriving its direct (actual or potential) competitors of the opportunity to improve their products and better challenge the incumbent.

19. The Report revealed gaps in the way previous merger decisions were analysed. First, the authorities did not always consistently frame the competition issues they were looking at in a two-sided setting. Second, the Report found that sometimes there were gaps in the authorities' understanding of digital markets. Third, when assessing potential competition, the authorities in these past cases dismissed some evidence due to the uncertainty surrounding it. According to the Report, the authorities should accept greater levels of uncertainty if they wish to investigate future potential competition in dynamic markets.

20. The Lear Report made a number of recommendations to the CMA. These included developing the CMA's approach to the substantive assessment of technology mergers, collecting a richer set of information to inform its analysis, and gaining a better understanding of digital markets. In relation to merger control in dynamic markets, the Report recommended:

- Reconsidering the appropriate timeframe for the counterfactual in a merger assessment and, in particular, whether a longer-term perspective should be taken, since even in fast-moving markets successful development may take some time. This might involve accepting more uncertainty in the evaluation of the counterfactual and extending the timeframe for the assessment beyond two years in appropriate cases.
- Greater willingness to accept uncertainty in the assessment of the counterfactual. This is because any assessment of future developments, no matter how well informed, is likely to contain a significant degree of uncertainty. This is particularly the case where the target is relatively young and at an early stage in its development.
- Considering a wider range of evidence than might be needed in more static markets. This may include placing more focus on the transaction value. For example, if the price paid by the acquirer does not appear to be based solely on its current or likely future earnings, the CMA should consider whether the purchase price may reflect the benefit of removing emerging competition.

4. Approach to merger control in dynamic markets in the UK

21. As dynamic markets can present a variety of different characteristics, there is not a fixed approach in how the CMA assesses these mergers. However, the CMA has recently examined several mergers in markets with strong dynamic elements. Some recent examples, which are discussed in more detail below, include *eBay/motors.co.uk*,¹¹ *Thermo Fisher/Gatan*,¹² *PayPal/iZettle*,¹³ *Experian/ClearScore*,¹⁴ and *ICE/Trayport*.¹⁵

22. Using these examples, this section describes the jurisdictional and substantive tools, sources of evidence, and potential remedies that are most relevant when the CMA assesses mergers in dynamic markets.

4.1. Jurisdictional tools

23. Before considering how to look at a merger, a competition authority needs to determine whether it has the jurisdiction to examine the merger in the first instance. Digital mergers may often involve target companies at an early stage of their life-cycle with a relatively low turnover. This often means that authorities with mandatory merger notification regimes based upon a turnover threshold for the acquirer and the target separately may not be able to establish jurisdiction to review these mergers.

24. Similarly, some transactions may not involve the acquisition of full control over the target but the acquisition of a minority shareholding. In those cases, whether a competition authority has jurisdiction to review the merger will depend on its rules on the degree of control required for it to have jurisdiction to assess the merger.

4.1.1. Share of supply test

25. In the UK, under the Enterprise Act 2002 (the Act),¹⁶ mergers are assessed by the CMA if they meet either the turnover or the share of supply test.¹⁷ ¹⁸ The share of supply test is satisfied if the merging parties will, post-merger, collectively supply or acquire more

¹¹ See case page for the *eBay/Motors.co.uk* merger: <https://www.gov.uk/cma-cases/ebay-inc-motors-co-uk-limited-merger-inquiry>

¹² See case page for the *Thermo Fisher/Roper* merger: <https://www.gov.uk/cma-cases/thermo-fisher-scientific-roper-technologies-merger-inquiry>

¹³ See case page for the *PayPal/iZettle* merger: <https://www.gov.uk/cma-cases/paypal-holdings-inc-izettle-ab-merger-inquiry>

¹⁴ See case page for the *Experian/ClearScore* merger: <https://www.gov.uk/cma-cases/experian-limited-credit-laser-holdings-clearscore>

¹⁵ See case page for the *ICE/Trayport* merger: <https://www.gov.uk/cma-cases/intercontinental-exchange-trayport-merger-inquiry>

¹⁶ The share of supply test is defined under Section 23 of the Act. See: <http://www.legislation.gov.uk/ukpga/2002/40/section/23>

¹⁷ Under Section 28 of the Enterprise Act 2002, the CMA also has jurisdiction to investigate a merger where the turnover of the enterprise that is being acquired exceeds £70 million. See: <http://www.legislation.gov.uk/ukpga/2002/40/section/28>

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than 25 per cent (or more) of certain goods and services in the UK or a substantial part of it, provided that the merger results in an increment to that share.

26. The Act therefore expressly gives the CMA a wide discretion in describing the relevant goods and services.¹⁹ The share of supply is different from the market share. That is, the goods and services to which the share of supply test is applied need not be the same as the market that is defined for the economic analysis. In addition, the CMA may have regard to any reasonable description of a set of goods and services to determine whether the share of supply test is met. Therefore, the CMA could define the share of supply using metrics such as value, cost, price, quantity, capacity, number of workers employed, or any other appropriate criterion to determine whether the 25 per cent threshold is reached.

27. The flexibility that the share of supply test allows the CMA enables it to assert jurisdiction in mergers involving companies with low revenues. This may be particularly effective where the CMA is considering whether to assess a merger where one or both of the merging parties are at a relatively early stage of their life-cycle. Specific examples of where the share of supply test has been effective in the assessment of dynamic mergers include the following:

- *Google/Waze*:²⁰ in the investigation of Google’s acquisition of Waze, a merger with a deal value of US\$ 966 million, the merging parties submitted that the OFT²¹ did not have jurisdiction to review the transaction on the basis that the services they provided (turn-by-turn navigational applications for mobile devices) are provided for free and hence do not represent an economic activity. However, the OFT considered that the merging parties had more than a 25 per cent share of supply in the supply of turn-by-turn navigation applications for mobile devices.²² This share of supply was based upon data provided by the merging parties on the number of downloads of turn-by-turn navigation applications.
- *Facebook/Instagram*:²³ in the OFT merger investigation into Facebook’s acquisition of Instagram (with a deal value of US\$ 300 million in cash plus approximately 23 million shares of Facebook common stock), the turnover test was not met since Instagram had not generated any revenue at the point when it was acquired. However, the OFT determined that the share of supply test had been met. This was because Facebook’s share of supply of virtual social networking services was greater than 25 per cent and the acquisition of Instagram would result in an increment. This share of supply was based upon data provided by Experian Hitwise – a third party market research company.

¹⁹ See paragraph 3.3.5 of the CMA’s Merger Assessment Guidelines: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

²⁰ See paragraphs 6 – 11 of the OFT’s decision in the *Google/Waze* merger: <https://assets.publishing.service.gov.uk/media/555de2cfed915d7ae2000027/motorola.pdf>

²¹ The OFT was one of the CMA’s predecessor organisations.

²² The OFT stated that “there is no requirement on the realisation of gain or reward from the business activity or that any such gain or reward is current or immediate, only that the activity is carried out for that purpose”. (Paragraph 8)

²³ See paragraphs 5 – 6 of the OFT’s decision in the *Facebook/Instagram* merger: <https://assets.publishing.service.gov.uk/media/555de2e5ed915d7ae200003b/facebook.pdf>

- *PayPal/iZettle*: in the CMA's merger investigation into PayPal's acquisition of iZettle, with a deal value of US\$ 2.2 billion, the turnover test was also not met since iZettle's revenue was below £70 million. However, the CMA determined that the share of supply test was met in the share of supply of mPOS (mobile point of sale) services on the basis of total payments volume (TPV) data submitted by the merging parties as well on the basis of the number of customers.

4.1.2. Material influence test

28. The CMA can review mergers which fall short of an acquisition of full control. In this case, the acquirer may have the ability materially to influence the policy of the target.²⁴ The ability to exercise 'material influence' is the lowest level of control that may give rise to a relevant merger situation. In assessing material influence in the context of the Act, the CMA will conduct a case-by-case analysis, focusing on the overall relationship between the acquirer and the target and on the acquirer's ability materially to influence policy relevant to the behaviour of the target entity in the marketplace. The policy of the target includes its strategic direction and its ability to define and achieve its commercial objectives.²⁵

29. In *Ryanair/Aer Lingus*,²⁶ the CC²⁷ found material influence with a 29.8% stake, while in *Sky/ITV*,²⁸ a shareholding of 17.9% was found to confer material influence.

30. This degree of flexibility, both in relation to the share of supply and material influence, is possible in a voluntary notification regime, such as that in place in the UK. This is because, under a compulsory notification regime, there must be clearly defined rules, usually based on the merging parties' turnover, on when enterprises must notify the transaction to the competition authority. This means that, in relation to mergers in dynamic markets, the CMA may have more flexibility in establishing jurisdiction to review these cases than in other regimes with turnover-based notification systems. Therefore, the CMA's flexible turnover and control tests allow more cases in dynamic markets to fall under its jurisdiction than in other authorities which may have more restrictive mandatory notification regimes.

²⁴ Section 26(3) of the Act. See: <http://www.legislation.gov.uk/ukpga/2002/40/section/23>

²⁵ See paragraph 3.2.8 of the CMA's Merger Assessment Guidelines: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

²⁶ See case page for the *Ryanair/Aer Lingus* merger: <https://www.gov.uk/cma-cases/ryanair-aer-lingus-merger-inquiry>

²⁷ The CC was one of the CMA's predecessor organisations.

²⁸ See case page for *Sky/ITV* merger: <https://www.gov.uk/cma-cases/british-sky-broadcasting-group-plc-itv-plc-merger-inquiry-cc>

4.2. Substantive tools

4.2.1. Legal test and uncertainty

31. When reviewing mergers, the CMA applies a legal test which must be met in order to determine whether a merger is potentially problematic.²⁹ During a Phase 1 investigation, the CMA must determine whether the merger creates a realistic prospect of a substantial lessening of competition. If this test is met and the merger moves to a phase 2 investigation, the CMA assesses whether the merger gives rise to an SLC on the balance of probabilities. That is, the CMA must determine whether a substantial lessening of competition is more likely than not.

32. The future competitive landscape is often less certain in a dynamic market (because of the degree of product and process innovation that typically characterises such markets). This means that it can be more difficult for the CMA to predict how a dynamic market will evolve in the future. Where a forward-looking assessment of the markets at issue is particularly important, the CMA will seek to gather evidence providing insight into competitive conditions in future. The fact that there may be a degree of uncertainty in how the market is likely to develop in future does not, by itself, reduce the likelihood that a merger could give rise to competition concerns. The CMA is not under an obligation to make findings of fact in relation to each item of evidence within its overall assessment of the probability of an SLC. Instead, the CMA must be satisfied that it has a sufficient basis, in light of the totality of the evidence available to it, for reaching the decision it does. Such judgements inevitably incorporate a significant degree of uncertainty. The UK courts have previously noted that “[w]hen looking to the future, any assessment is likely to be imprecise and unpredictable [...]” and have consistently upheld that the CMA has wide a margin of appreciation for economic judgement, particularly in merger cases.³⁰ Accordingly, the degree of uncertainty often found in dynamic markets does not (and should not) lead to a bias against intervention.

4.2.2. Dynamic counterfactuals

33. Mergers in dynamic markets may involve complex analysis of what is the appropriate counterfactual, as well as what is the appropriate timeframe for assessing the counterfactual.³¹

²⁹ See paragraphs 2.4 – 2.13 of the CMA’s Merger Assessment Guidelines: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

³⁰ *Intercontinental Exchange, Inc. v CMA and Nasdaq Stockholm AB [2017] CAT 6*, at paragraph 246. See also *Société Coopérative de Production SeaFrance SA (Respondent) v CMA [24/07/2014] CAT*, and another [2015] UKSC 75 at paragraph 44. See: https://www.catribunal.org.uk/sites/default/files/1271_ICE_Judgment_CAT_6_060317.pdf <https://www.catribunal.org.uk/cases/123541214-societe-cooperative-de-production-seafrance-sa> https://www.catribunal.org.uk/sites/default/files/1235_SCOP_Judgment_Of_the_Supreme_Court_161215.pdf

³¹ The application of the SLC test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the “counterfactual”. The counterfactual is an analytical tool used in answering the question of whether the merger gives rise to an SLC (Merger Assessment Guidelines, paragraph 4.3.1:

34. In the UK, the starting point for the counterfactual is often “the prevailing conditions of competition” (or the pre-merger situation in case of completed mergers). However, due to the rapidly changing conditions which characterise a dynamic market, the future may be quite different to the specific circumstances which existed prior to the merger. Therefore, when assessing a merger in a dynamic market, it may be necessary to consider whether the prevailing conditions of competition are, indeed, the most appropriate counterfactual. It is also important to note that prevailing conditions can include an evolving dynamic market which should be taken into account when examining what the relevant prevailing conditions of competition are.

35. Factors which are considered in a dynamic counterfactual include what actions the acquirer would have taken absent the transaction and also whether the target would have become a stronger competitor over time compared to their historical performance. Some recent examples of these factors which were considered to be dynamic counterfactuals by the CMA include the following:

- In *eBay/motors.co.uk*,³² the CMA considered whether, absent the merger, eBay would have increased investment in its online classified vehicle advertising services and therefore become a stronger competitor. In that case the CMA ultimately concluded that a more competitive counterfactual should not be applied because, while eBay had a clear strategy to invest in online vehicle advertising in the UK, this strategy did not include a commitment to organic growth over and above the investment needed to remain competitive in the UK market. Therefore, in that case, the CMA concluded that prevailing conditions of competition were the appropriate relevant counterfactual.
- In *PayPal/iZettle*,³³ the CMA examined whether PayPal would invest in an “offline product” to complement its online payments product and to support its aspiration of developing a leading omni-channel service offering. The CMA reviewed the evidence from PayPal’s internal documents that showed that a variety of investment, acquisition and partnering options were considered by PayPal. The CMA found that PayPal had a very strong incentive to develop its offline payment service and enhance its omni-channel offer and was satisfied that it could and would have achieved this through one or more measures.³⁴ However, the CMA also took the view that this would have taken time and that the timing and impact of such an improvement is dependent upon the means by which it was achieved. On this basis, the CMA found that under the counterfactual it is likely that PayPal would have been a stronger competitor than it currently is, although there are limitations of what PayPal could achieve in the shorter term.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf

³² See case page for the *eBay/Motors.co.uk* merger: <https://www.gov.uk/cma-cases/ebay-inc-motors-co-uk-limited-merger-inquiry>.

³³ Section 7 of Final Report in the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

³⁴ Omni-channel services are an emerging trend in payment services, whereby the same provider supplies merchants with integrated offline and online payment services, possibly alongside other services such as sales management tools.

36. In relation to the relevant timeframe for the counterfactual, the nature of dynamic markets may mean that the CMA may need to look at a wider timespan when considering the effect that a merger is likely to have on competition in the market under consideration. The timeframe over which the CMA assesses future competition in dynamic mergers is dependent on the characteristics and, in particular, the dynamics of the market under consideration.

37. For example, in *PayPal/iZettle*,³⁵ the CMA considered the timeframe for the relevant counterfactual in the context of the nascent development of omni-channel payment services which, at the time, were at an embryonic stage and were expected to develop over time. In this case, the CMA noted that in markets characterised by rapid growth and a significant degree of product development and innovation, competitive constraint posed by a firm may not be captured by a “snapshot” of its market position at any one time. Therefore, the CMA should gather evidence providing insight into the likely competitive conditions over several years.

38. Overall, the timeframe that the CMA assesses future competition in dynamic mergers is dependent on the characteristics and, in particular, the dynamics of the market under consideration.

4.2.3. Loss of potential competition

39. Another element of merger assessment in relation to dynamic markets may be the loss of potential competition, for example when one party to the merger is planning to enter or expand in the market of the other party.

40. When assessing mergers in dynamic markets, the CMA considers whether one of the firms which is not a current competitor has the capabilities to become a competitor in the future. The CMA may also consider whether the two merging parties have competitive advantages that support their long-term competitive strength. The two merging parties may both have strong positions in adjacent or complementary markets, or the potential competitor may have some scarce skill or resource. A competition authority will typically seek to understand the current competitive situation and how it may develop post-merger. For example, it may be that in a heavily fragmented and competitive market, and/or a market with low barriers to entry, the loss of a potential competitor is not a competition concern, whereas in a highly concentrated market with high barriers to entry, it may be considered problematic.

41. In the case of the *PayPal/iZettle* merger, PayPal’s rationale for the merger was to combine two complementary product offerings (online and offline payments) to build its omni-channel product offering to merchants.³⁶ Omni-channel services are an emerging trend in payment services, whereby the same provider supplies merchants with integrated offline and online payment services, possibly alongside other services such as sales

³⁵ Paragraphs 5.1 to 5.10 of Final Report in the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

³⁶ See paragraphs 4.4-4.8 of the Final Report for the *PayPal/iZettle* merger:

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

management tools. PayPal is an established business in the market for online payments while iZettle is the largest supplier of mPOS services.³⁷

42. The CMA was concerned that the merger may lead to the removal of a potential future competitor in the market for omni-channel payments. In its Phase 2 review, the CMA concluded that, under the counterfactual where the two businesses remained independent, iZettle would not have provided much competitive constraint in omni-channel payment services due to the small scale of its intended expansion plans. The CMA identified several providers that have entered or acquired e-commerce capabilities and are developing their omni-channel propositions, while others had indicated that they have plans to expand into the omni-channel market. Given the existence of significant competitors and the likelihood of future entry, the small scale of intended expansion by iZettle absent the merger, did not lead the CMA to conclude that iZettle's planned expansion in omni-channel would lead to greater competition.

4.2.4. Non-price effects, including innovation

43. Mergers in dynamic markets may also have non-price effects, such as the loss of innovation when one party to the merger is expected to make innovation that will not materialise post-merger.

44. One case where the CMA examined non-price effects in its merger assessment is *Thermo Fisher/Gatan*.³⁸ Thermo Fisher is a leading producer of electronic microscopes and Gatan is a leading supplier of cameras and other "peripherals" for such microscopes. The anticipated merger was both vertical and horizontal in nature. The CMA placed considerable weight on non-price effects, such as potential reductions in quality and future innovation.

45. In that case, the development of the transmission electron microscope (EM) cameras was widely seen as a critical breakthrough that enabled the emergence of cryo-EM.³⁹ These innovations highlighted the importance of non-price parameters of competition and meant that the CMA was highly mindful of the potential role of competition in promoting important scientific advances. The CMA considered whether access to commercially sensitive information related to Thermo Fisher's rivals' technical product specification information and product innovation plans would enable it to compete less aggressively against its rivals and/or otherwise put its rivals at a competitive disadvantage.

³⁷ See Table 9 of the Final Report for the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

Although PayPal is also active in the mPOS market, but its market share is significantly smaller than iZettle's.

³⁸ See case page for the *Thermo Fisher/Gatan* merger: <https://www.gov.uk/cma-cases/thermo-fisher-scientific-roper-technologies-merger-inquiry>.

³⁹ Electron microscopes are used to observe small particles in life sciences, materials science, and semi-conductor analysis. They use electron beams to produce an image of a specimen, resulting in greater magnification and resolving power than an optical microscope. Cryo-EM overcomes some of the issues around sample sensitivity to the electron beam by keeping the sample frozen.

46. The CMA provisionally found⁴⁰ that the merged entity would have the ability and incentive to foreclose downstream rivals, resulting in higher prices, reduced quality, and potentially resulting in market exit. The CMA also had concerns regarding Thermo Fisher's access to the confidential information of its downstream rivals and some reduced horizontal competition. The merger was abandoned in June 2019 following a provisional decision by the CMA that it would result in a substantial lessening of competition. The abandonment was announced shortly before the CMA's final report was due.

47. Another case where innovation was considered was *Experian/ClearScore*.⁴¹ In that case, the CMA examined whether, after the merger, the quality of the merging parties' free products would be worse compared to that absent the merger. This could be due to lower investment in new product features and functionalities, a slower pace of development, or less effort to improve customers' experiences.

48. ClearScore had only entered this industry in July 2015 and had been operating for just two and a half years before the merger was agreed. In that time, ClearScore grew rapidly to become the UK's leading provider of credit scores and reports. ClearScore's entry had a significant impact on Experian's strategy and affected sales of Experian's paid-for product. Furthermore, Experian also launched its own free credit score product and accompanying financial comparison service in June 2016, thus competing directly with ClearScore.

49. The CMA found that competition between Experian and ClearScore's free products took place in the form of marketing and incremental product developments. The CMA provisionally considered that the loss of competition based on these non-price factors was likely to lead to harm for consumers. In considering the impact of these non-price effects, the CMA made its provisional assessment in much the same way as it does when assessing a price increase. That is, the CMA considers how the merger may have a detrimental impact on factors such as the quality of the products and service being offered and the range of products available to consumers.⁴²

50. The *Experian/ClearScore* merger demonstrates the CMA's ability to assess a non-price theory of harm in a dynamic, digital market using current laws and its usual substantive assessment frameworks.⁴³

51. Finally, in *ICE/Trayport*,⁴⁴ the CMA found that there is dynamic competition between venues and clearing houses which takes place through the introduction of new products and innovative trading solutions, including seeking to develop competition in new

⁴⁰ See the CMA's Provisional Findings for the *Thermo Fisher/Gatan* merger: https://assets.publishing.service.gov.uk/media/5cb71961ed915d3f312cdd1f/Thermo_Fisher_Roper_Provisional_Findings_pdf_a.pdf

⁴¹ See case page for the *Experian/ClearScore* merger: <https://www.gov.uk/cma-cases/experian-limited-credit-laser-holdings-clearscore>

⁴² See the CMA's Provisional Findings for the *Experian/ClearScore* merger: https://assets.publishing.service.gov.uk/media/5c065b8140f0b6705f11cf17/experian_clearscore_provisional_findings.pdf

⁴³ Ultimately the parties abandoned the merger and on 27 February 2019 the CMA cancelled the reference.

⁴⁴ See case page for the *ICE/Trayport* merger: <https://www.gov.uk/cma-cases/intercontinental-exchange-trayport-merger-inquiry>

markets.⁴⁵ In this case, innovation and first mover advantage were considered important competitive factors when seeking to implement an innovative solution or establish a new market. The CMA considered that Trayport supported dynamic competition through specific initiatives. One example of these initiatives is supporting its customers' (trading venues') efforts to shift from traditional voice brokered markets to an electronic trading process.⁴⁶

4.3. Sources of evidence in dynamic merger inquiries

52. In this section, the paper discusses in more detail the types of evidence the CMA has gathered when assessing the competitive effects of mergers in dynamic markets. The paper also considers the limitations of historical and static evidence (such as market shares). Finally, the paper considers some alternative methods for collecting evidence such as dawn raids, as proposed in the Lear Report.

4.3.1. Deal valuation materials

53. The CMA may scrutinise the price of the company acquired and consider in detail the models used by the acquirer to value the target. For example, the valuation of the target business could include a premium to account for the potential future market power of the target (with this premium being seen as worthwhile for the acquiring business in order to eliminate future competition). More broadly, the valuation of a target business can also provide some insight into the acquirer's expectations around the future trajectory of the target (and the risks that the competition faced by the target presents to future growth).

54. The potential significance of the valuation of a target business was identified by the Furman Review which was discussed in more detail above.⁴⁷ Specifically, the Review suggested that the CMA should “*draw attention to the evidential relevance of the transaction value relative to the market value and company turnover, and the importance of understanding the rationale for valuations which appear exceptionally high*”. Exceptionally, high valuations may signal the projected target's expansion in the future. An example of this is Facebook's acquisition of Instagram which, at the time, consisted of 13 employees, made zero revenue, yet was purchased for US\$300 million in cash plus nearly 23 million shares of Facebook common stock.

55. The comparison of the market valuation of a company against its acquisition price will also typically consider the extent to which valuations reflect synergies that are considered likely to arise as a result of the merger.

⁴⁵ ICE and Trayport supply services to participants in wholesale energy trading. ICE is a global operator of derivatives exchanges and clearinghouses, and Trayport supplies software technology to traders, brokers and clearinghouses. The CMA found that the merger resulted in a loss of competition and that in order to remedy this IEC must sell the Trayport business. The parties appealed to the Competition Appeal Tribunal which upheld the CMA's findings on the loss of competition. The sale completed on 14 December 2017m bringing the merger investigation to a close.

⁴⁶ See the CMA's Final Report for the *ICE/Trayport* merger: <https://assets.publishing.service.gov.uk/media/58049a0740f0b64fbc000006/ice-trayport-final-report.pdf>

⁴⁷ See Furman Review, Box 3.A: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf

56. The target's valuation as a means of determining the motivation behind the acquisition was taken into account by the CMA in the *PayPal/iZettle* merger investigation.⁴⁸ In this case, iZettle was planning an Initial Public Offering (IPO) of its business and the valuation that PayPal placed on the iZettle business was much higher than the proposed IPO valuation. The CMA further examined whether this was suggestive of a potential reduction in competition.

57. In particular, the CMA further looked at PayPal's valuation and estimates of synergies, as set out in its internal documents and deal model, as well as broker comments at the time of the acquisition. Taking all of this evidence into account, the ultimately CMA found that the price that PayPal paid for iZettle appeared justified by commercial valuation and calculations of synergies including sales volumes and cost savings (rather than reflecting a premium justified by the elimination of future competition).

4.3.2. Internal documents

58. Due to the forward-looking nature of dynamic markets, it is important to tap into the appropriate evidence base to enable the CMA to form its views on future competition, both with and without the effects of the merger. One relevant source of evidence can be the internal documents of the merging parties and competitors that discuss possible future developments.

Internal documents from the parties

59. The internal documents of market participants often set out their respective commercial strategies several years into the future, providing insight into how the markets, and the suppliers' offerings, are likely to develop in the future. In particular, internal documents may spell out what product developments the merging parties are planning on bringing to the market, what their growth ambitions are, what competitive threats they foresee, and what actions they intend to take in order to respond to these competitive threats. In addition to conventional business plans, the CMA's internal document request may include internal emails from the merging parties focusing on their business plans absent the merger.

60. When assessing internal documents, the CMA attempts to place evidential weight on the document based on the context surrounding it. In particular, the CMA will take account of the author(s) and the intended audience of the documents. For example, a report produced for the Board of Directors is likely to be more important than a document produced for the middle-management. The CMA may also look at the internal processes for the merging parties' decision-making, and whether documents have been brought further to the upper management and/or approved by the Board of Directors or decision-makers in the management chain.

61. In *PayPal/iZettle* merger investigation, the CMA assessed PayPal's internal documents to understand the range of options available to improve its mPOS offering under a counterfactual scenario in which the merger does not happen.⁴⁹ Ultimately the CMA did not conclude on which option PayPal was most likely to pursue. However, the CMA was

⁴⁸ See paragraphs 4.12-4.14 of the Final Report for the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

⁴⁹ See paragraphs 7.32-7.36 of the Final Report for the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

able to conclude that the evidence, as a whole, indicated that PayPal would have sought to improve its mPOS product absent the merger. In evaluating these internal documents, the CMA took into consideration the context in which they were drafted and presented.

62. Another example of the CMA's use of internal documents in its assessment of a dynamic merger is *Experian/ClearScore*.⁵⁰ In that case, an extensive review of the merging parties' internal documents showed the degree of monitoring and competition of each other, e.g. the extent to which the merging parties pay attention to new products and improvements made by each other, the effects of the other party's advertising and marketing, and discussions of their competitive responses.

Internal documents from third party competitors

63. The CMA may also request internal documents from the merging parties' current or potential competitors in order to assess their future plans. The CMA's request for internal documents from third parties will typically be focused on their commercial strategies and plans going forward. This will give the CMA a more comprehensive picture of how competition is likely to develop in the near future and the competitive constraint that these rivals would exert on the merging parties. In doing this the CMA will weigh the parties' market projections against its rivals' plans.

64. In the *PayPal/iZettle* case, the CMA requested internal documents from several of the merging parties' rivals. For example, the CMA requested documents from Square, one of the parties' main rivals in the mPOS market.⁵¹ Square's Annual Planning document stated that it plans to "*drive a step change in UK growth*". However, given that these plans were still at an early stage of development, the CMA did not place weight on them.

65. Therefore, the CMA will assess third parties' future plans depending on how developed the plans are, how likely these plans are to succeed, and how ambitious they are relative to the merging parties and to other competitors in the market.

Evidence from other third party sources

66. In addition to internal documents from the merging parties and their competitors, the CMA may also take account of other third-party evidence, such as industry forecasts, investment analyst reports, and the valuation of the deal. The CMA may also consult with the industry experts.

67. Overall, when the CMA is assessing future competition in dynamic markets, it may request a wide range of information from various stakeholders. The CMA believes internal documents produced by the parties are likely to be a key source of evidence. However, the CMA will weigh the importance of these documents against their context as well as the internal documents of third-party competitors, industry forecasts, investment analyst reports, and consultations with industry experts.

⁵⁰ See case page for the *Experian/ClearScore* merger: <https://www.gov.uk/cma-cases/experian-limited-credit-laser-holdings-clearscore>

⁵¹ See paragraphs 8.116-8.117 of the Final Report for the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

4.3.3. Limitations of historical and static evidence (such as market shares, switching rates, win/loss data)

68. One important difference between the assessment of mergers in static and dynamic markets is the weight that the CMA places on historical data.

69. When assessing the competitive effects of a merger in a traditional static market, the CMA will typically consider historical data and evidence such as market shares, switching rates, and customer win/loss data. This is because historical data is likely to be informative of competition in the near future.

70. In dynamic markets, historical data is likely to be less informative about how competition is likely to develop in the near future since firms are continuously looking to bring more innovative products or features to market. In this case, the CMA would seek more forward-looking evidence.

71. Nevertheless, historical data may be a useful indicator of future trends and, thus, of competition in the near future. As an example, a market may contain a disruptive firm which has released a particularly innovative product. Historical market shares may show a trend of the disruptor gaining market share from less innovative rivals in the market and this disruption would be expected to continue into the near future.

72. As an example, in *PayPal/iZettle* historical shares of supply showed that PayPal's share of supply in the provision of mPOS was significant (with PayPal being the second largest player in the market by some counts).⁵² However, in light of the dynamic and fast-growing nature of the market, the CMA also considered trends in new customer acquisition, which showed that PayPal's rate of growth was declining, in contrast of the rates of growth of the parties' main competitors.

73. Overall, the CMA will consider both historical and forward-looking evidence when attempting to forecast the future competitive conditions in a dynamic market. However, the nature of dynamic markets means that the CMA is likely to place more evidential weight on forward-looking evidence rather than historical evidence.

4.3.4. Particular challenges for evidence-gathering in dynamic markets?

74. The Lear Report suggests that in some merger cases it may be helpful to use dawn raids, as these may uncover valuable evidence such as the future plans of the target and whether the incumbent perceived the target as a threat.⁵³ The Lear Report suggests that this would not be unprecedented, with the European Commission having previously carried out dawn raids at the premises of merging parties in certain cases (albeit predominantly in cases where gun-jumping was suspected).

75. In the CMA's experience, it is not clear what added value might be provided by dawn raids where merging parties comply effectively with the other requests within the competition authority's statutory information-gathering powers. This suggestion does,

⁵² See paragraphs 8.47-8.51 of the Final Report for the *PayPal/iZettle* merger: https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf

⁵³ See pages 10 and 44-45 of the Lear Report, Ex-post Assessment of Merger Control Decisions in Digital Markets (June 2019): <https://www.gov.uk/government/publications/assessment-of-merger-control-decisions-in-digital-markets>

however, highlight the ever-increasing importance of internal documents to the CMA's merger assessment.

76. The CMA has wide ranging investigatory powers under section 109 of the Act. Under section 109(2), the CMA may request a wide range of documents, including the type of documents suggested in the Lear Report. The CMA has the power, under section 109(1) of the Act to require any person by notice to give oral evidence to the CMA (whether by telephone or in-person). The taking of this kind of "deposition" evidence, which was used recently in *Inspired/Novomatic*, may be particularly well-suited to cases in dynamic markets where it may be important (particularly in the absence of material volumes of contemporaneous internal documents) to fully understand the rationale for the acquisition or the merging businesses' plans absent the merger.⁵⁴ The CMA has issued guidance on the use of internal documents in merger investigations.⁵⁵

4.4. Remedies in dynamic markets

77. In some dynamic merger investigations, merging parties have sought to offer behavioural remedies to address the concerns identified. These remedies may often include enabling measures, such as competitors being given access to the products and facilities of a merged entity or firewall measures (which seek to prevent a vertically integrated company from accessing and using legally privileged information generated by competitors' use of the merged company's facilities or products).

78. In merger investigations, the CMA will generally prefer structural remedies over behavioural ones. This is because behavioural remedies may not have an effective impact on competition and the resulting adverse effects may create significant costly distortions in market outcomes, thus requiring ongoing monitoring and enforcement once implemented.

79. For example, in *Experian/ClearScore*, at the time of its provisional findings the CMA noted that a behavioural remedy was not likely to be an effective remedy to the provisional SLC identified at that stage.⁵⁶ In particular, having regard to the dynamic nature of the market and the resultant dynamic nature of competition between the parties, the CMA noted that the SLC related to a decrease in the merging parties' incentives to improve and innovate in terms of product development, quality and range. As the exact nature of product development and innovation is not predictable it did not appear possible to design a behavioural remedy that would effectively address all potential product developments and innovations by the merging parties over the lifetime of the SLC.

⁵⁴ This case involved the merger of two manufacturers of gaming machines for licensed betting offices, bingo halls, and the servicing and maintenance of self-service betting terminals: https://assets.publishing.service.gov.uk/media/5db17ea2e5274a0920a53611/inspired_entertainment_novomatic_full_text_decision.pdf

⁵⁵ See CMA's guidance on internal documents: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/773103/guidance_on_internal_documents_in_merger_investigations.pdf

⁵⁶ See remedies notice in the *Experian/ClearScore* merger: https://assets.publishing.service.gov.uk/media/5bfd826fed915d11aa497a58/remedies_notice.pdf

80. In the *Thermo Fisher/Gatan* merger investigation, the CMA considered whether behavioural remedies, such as access remedies on fair, reasonable and non-discriminatory (FRAND) terms, would be appropriate to address its vertical concerns.⁵⁷ The CMA considered whether a type of access remedy could maintain or restore elements of pre-merger competition. The CMA was concerned that the access remedy may not be effective because it is unlikely to produce the innovation and efficiency generated by dynamic competition. Other concerns were that, because of the complexity of the market, it might not be possible to specify an effective access remedy, and/or to design a remedy so that it covered all new products and services. Moreover, customers may not be able to identify whether or not they were being given access on FRAND terms.

81. Finally, in the *ICE/Trayport* merger, the CMA considered whether behavioural remedies would be appropriate. One of the behavioural remedies proposed was to ensure that Trayport's products were offered on a FRAND basis. The CMA noted that, in dynamic and evolving sectors such as those in which ICE and Trayport operate, it was inherently difficult to specify FRAND terms that would cater for all eventualities. Having taken into account other issues, such as those related to design, implementation, monitoring and enforcement of such remedies, the CMA found that behavioural remedies would not be effective.⁵⁸

82. To conclude, the CMA consider that the application of behavioural remedies to address competition concerns in dynamic merger cases is challenging. In particular, when designing such remedies, the CMA has been faced with uncertainty relating to changing market conditions as well as future product developments and innovation. Other issues concern the implementation, monitoring and enforcement of such remedies.

4.5. Potential enhancement of merger control tools for dynamic markets

83. The CMA currently considers that, based on its experience of merger control in dynamic markets to date, existing tools are generally fit-for-purpose and that the cases above show that the existing UK merger framework can accommodate the appropriate evolution in the theories of harm and evidence-gathering for dynamic mergers. The CMA is, however, keen to further clarify and supplement the guidance provided on the substantive assessment of mergers in digital markets, and recently concluded a 'call for input' intended to feed into forthcoming changes to its Merger Assessment Guidelines. The CMA is also actively considering whether there might be a need for some form of closer scrutiny for acquisitions, particularly digital platforms which are in a position to exercise market power over a gateway or bottleneck in a digital market, where they could control others' market access.

⁵⁷ See paragraphs 28 – 41 of remedies notice in the *Thermo Fisher/Gatan* merger: https://assets.publishing.service.gov.uk/media/5cb6f07640f0b649e2810db3/final_-_remedies_notice_thermo_fisher.pdf

⁵⁸ See the CMA's Final Report in the *ICE/Trayport* merger: <https://assets.publishing.service.gov.uk/media/58049a0740f0b64fbc000006/ice-trayport-final-report.pdf>