CRA response to the CMA Merger Remedies Review Call for Evidence

Prepared for

Competition and Market Authority

United Kingdom

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1. INTRODUCTION

1. The authors welcome the opportunity to contribute to the Competition and Market Authority's ("CMA") Merger Remedies Review.[1] Since the publication of the 2018 Merger Remedies Guidance,[2] there have been several years of decisional practice and some substantial developments in the case law. As such we agree that it is an appropriate time to take stock and provide updated guidance.

2. In what follows we set out our views on some key economic themes raised by the Merger Remedies Review Call for Evidence ("Merger Remedies CFE"), including the circumstances in which behavioural remedies might be most appropriate; when and how enabling measures such as investment remedies might be adopted; and how the CMA might ensure due consideration of efficiencies in the merger control process. In summary, we agree that the CMA can do more around remedies and efficiencies to facilitate beneficial mergers, particularly in vertical mergers, however we think that the CMA should consider the market circumstances carefully before accepting complicated behavioural remedies in horizontal mergers.

3. These comments have been prepared by Ugur Akgun, Matthew Bennett, Matteo Foschi, Oliver Latham, Sara Ross, and Benoit Voudon. They do not necessarily reflect the views of Charles River Associates ("CRA") as an organisation or of our CRA colleagues. While our comments reflect our experience from merger cases we have worked on in front of the CMA and elsewhere, the views held within this response are independent of any external advice or recommendations. This document was solely reviewed by employees of CRA.

2. REMEDIES

4. One of the key themes in the Merger Remedies CFE is the CMA's approach to behavioural remedies,[3] in particular, the circumstances in which behavioural remedies are likely to be appropriate.

5. As an overarching point, we consider that behavioural remedies are potentially useful in cases where a structural solution (for example a full or even partial divestment) threatens the realisation of merger specific efficiencies. In these circumstances, a suitably designed behavioural remedy may address the SLC (in whole or part) but preserve these merger specific benefits and, in doing so, lead to better consumer welfare outcomes compared with a structural solution.

6. As the remainder of this section sets out, our general view is that there is a clear role for behavioural remedies in relation to vertical/conglomerate mergers whereas finding effective

1 https://connect.cma.gov.uk/review-of-merger-remedies-approach

2 Merger Remedies Guidance (CMA 87), 13 December 2018, https://www.gov.uk/government/publications/merger-remedies

3 The Merger Remedies Guidance (CMA 87), defines a behavioural remedy as "designed to address an SLC and/or its adverse effects by regulating the ongoing conduct of parties following a merger". The Guidance makes clear that the CMA will generally only use behavioural remedies as the primary source of remedial action where: (a) structural remedies are not feasible; (b) the SLC is expected to have a short duration; or (c) at Phase 2, behavioural measures will preserve substantial RCBs that would be largely removed by structural measures. (CMA 87, Paragraphs 7.1-7.2.)

behavioural remedies in a horizontal setting is more challenging and is only likely to be appropriate in a relatively narrow range of circumstances. This is in part based on the greater difficulty of designing behavioural remedies to replicate outcomes of a competitive process (for example price, quality, and innovations), compared with designing behavioural remedies that attempt to ensure continued competitor access to the inputs into the competitive process (such as an access or no bundling remedy). We also see scope for the CMA to adopt a more flexible approach to structural remedies when remedying horizontal mergers, in particular in terms of how it specifies the scale of structural remedies, and we discuss this in the final part of this section.

2.1. Behavioural remedies have a role to play in vertical / conglomerate mergers

7. In our view, where behavioural remedies have a clear role to play is in the context of vertical /conglomerate mergers. This is for several reasons.

8. First, vertical/conglomerate mergers are in general likely to generate merger specific benefits[4] that in turn may be threatened by a structural remedy. This is because they often lead to a change in pricing incentives which automatically generate efficiencies as a result of the "removal of double marginalisation"[5] (This is not to say that horizontal mergers are not capable of generating merger specific benefits e.g. as a result of marginal cost reductions, but there is not the same strength of presumption that they will). There is therefore a strong case to consider behavioural remedies in the context of vertical/conglomerate mergers, to target any SLC whilst preserving the merger specific efficiencies. This approach is consistent with academic papers that have investigated the efficacy of behavioural access rules in the context of vertical integration.[6]

9. Second, one of the main concerns regarding behavioural remedies is the need to police them going forward. This ties up resources that could be focussed on enforcing competition policy elsewhere. However, we consider that behavioural remedies in the context of vertical mergers such as access remedies are often likely to be amenable to policing by a combination of a downstream competitors and/or a monitoring trustee to which both Parties can appeal should disagreement arise. Such remedies may be particularly readily implementable when access already exists today, and hence there is already an understanding of what the product looks like and what is a reasonable price.

4 Under the CMA Merger Assessment Guidance, merger specific benefits can be classified as either REEs (Rivalry Enhancing Efficiencies) or RCBs (Relevant Customer Benefits). REEs are *"Efficiencies that change the incentives of the merger firms and induce them to act as stronger competitors to their rivals—for example, by reducing their marginal costs giving them the incentive to provide lower prices or a better quality, range or service.*" RCBs are "*Benefits to UK customers resulting from a merger, other than through improved competition in the market related to the SLC finding—for example, greater levels of innovation resulting from the combination of unique assets of the merger firms applying to products other than those where the firms compete, or reduced carbon emissions (to the extent firms do not normally compete on sustainability)*". CMA 129, Paragraph 8.3.

5 See seminal paper by Spengler, Joseph J. "Vertical integration and antitrust policy." *Journal of political economy* 58.4 (1950): 347-352.

6 See, for example, Crawford et al. (2018) which finds that in the US multichannel TV market, vertical integration with program access rules (a behavioural rule which ensures that non-integrated rival distributors have access to integrated content) is the socially optimal outcome. Crawford, Gregory S., et al. "The welfare effects of vertical integration in multichannel television markets." *Econometrica* 86.3 (2018): 891-954.

10. Third, behavioural remedies in vertical markets, particularly access remedies, have been used extensively in EC cases. This includes cases such as *Qualcomm/NXP*, *Microsoft/LinkedIn*, *Broadcom/Brocade*, *Daimler/BMW car sharing JV* and *Microsoft/Activision*.[7] To our knowledge there have not been significant issues regarding either their effectiveness, or how they have been implemented. To our understanding, the EC commonly uses a Monitoring Trustee, paid for by the Parties, in order to minimise the time that the EC needs to police the remedies. This may be a solution that the CMA also wants to consider.

11. Finally, whilst we consider that behavioural remedies may be an effective means to ensure that a merger with potentially large efficiencies is not blocked on the basis of a vertical concern, we would caution against behavioural remedies becoming the new 'norm' in vertical mergers. We believe that the CMA should continue to consider whether a vertical merger is likely to be problematic on the basis of weighing up the harm and efficiencies, and where this is not the case, the CMA should clear the merger outright. Behavioural remedies should only be applied where there is a clear potential concern that the merger without remedies is more likely to lead to harm than not, and the merger would not go through absent such a remedy. They should not be required just because there is some probability of the merger leading to harm, even though the balance of probabilities indicates no harm is more likely.

2.2. Designing effective behavioural remedies for horizontal mergers is more challenging

12. Whilst we consider that behavioural remedies have a role to play in vertical mergers, we are of the view that finding effective behavioural remedies is significantly more challenging for horizontal mergers. Horizontal mergers that have been found to meet the SLC test are those which have likely changed the merging parties' incentives in such a way that, post-merger, they face fundamentally weaker incentives to compete on price and/or other dimensions of competition such a quality and innovation. Against such a backdrop, behavioural remedies are only likely to be effective in specific circumstances and, where these are not present, there are likely to be difficulties designing effective behavioural remedies that do not risk unintended consequences, or push the CMA towards becoming a regulatory body.

13. As this section sets out, these challenges are more acute in the case of what the current CMA Merger Guidance[8] calls "controlling measures" (i.e. measures which seek to restrict the adverse effects by controlling market outcomes, such as through a cap on prices). Innovative "enabling measures" such as investment commitments that seek to change the incentives of the merged entity may be capable of addressing some of the risks but are still likely to be only appropriate in a relatively small number of cases.

7 *Qualcomm/NXP* Case M.8306, *Microsoft/LinkedIn* Case M.8124, *Broadcom/Brocade* Case M.8314, *Daimler / BMW car sharing JV* Case M.8744 and *Microsoft/Activision* Case M.10646.

8 CMA 87, Paragraph 7.12.

2.2.1. Designing effective behavioural remedies that seek to control market outcomes is often challenging and only likely to be appropriate under specific conditions

14. There are several reasons why behavioural remedies that seek to control market outcomes are often challenging to design. First, there is an inherent difficulty defining the scope of the remedy. In many markets, competition takes place over multiple dimensions such as price, quality, range, and service. Designing a behavioural remedy that is capable of controlling outcomes in relation to all these dimensions is inherently challenging and there is a risk that the behavioural controls are insufficiently broad in scope to prevent the merging parties from being able to exercise market power post-merger, leading to consumer harm (for example a focus on price caps alone may still permit the merging parties to reduce quality or service). However, the broader the scope of the remedy, the more complex and interventionist the behavioural controls become. Unless there are relevant benchmarks (i.e. un-distorted by the loss of horizontal competition), it can be difficult to design controls that do not themselves lead to significant market distortions. This risk will tend to increase with (amongst other issues) the importance of competitive dimensions other than price, the complexity of the counterfactual, and the number of linkages between and complexity of the products.

15. Second, behavioural controls tend to ossify the market, and it can be challenging and complex to design behavioural controls to preserve incentives for dynamic competition. Part of this ossification derives from the fact that it is difficult to design behavioural controls in such a way that they address the SLC whilst preserving incentives for new entry which in our view is very important for maintaining a healthy competitive process. Other things equal, this will tend to make behavioural controls unsuitable for horizontal SLCs of a long duration, i.e. in circumstances where there is no expectation that long-term dynamics or other market developments will address the SLC. In these circumstances, the ossifying effect of the behavioural controls can themselves risk drawing out the duration of the SLC, making it hard for the regulator to remove the behavioural controls without adverse effects from the SLC re-emerging. This risks replacing the competitive process with a long-term regulatory process.

16. Third, the costs and risks of the ongoing monitoring of the remedy in a horizontal context risk taking up valuable resources, with longer term and more sophisticated behavioural remedies taking up greater resources. Even with the best intentions, it can also be hard to design a process that entirely rules out the risk of "regulatory capture", particularly where customers/consumers may be insufficiently concentrated to effectively represent any concerns.

17. One specific area where behavioural controls could have more of a role to play is in 'stop gap' situations where the market structure is expected to change going forward (ensuring any SLC is relatively short lived), or in conjunction with other remedies that are expected to change the incentive structure of firms in the longer time frame. Whilst many of the issues set out above will still apply, the limited timeframe of such remedies is likely to mitigate these issues.

2.2.2. Innovative behavioural enabling measures such as investment commitments could incentivise competition and may be appropriate in specific situations

18. As noted above, the CMA draws a distinction between behavioural measures which seek to control market outcomes from those which seek to remove obstacles to competition or

stimulate competition, termed "enabling measures". The CMA Merger Remedies Guidance[9] draws a further distinction between enabling measures that restrain the impact of vertical mergers and measures that restrain market power in a horizontal market context. Examples given by the CMA of those that restrain market power in a horizontal context include prohibiting, restricting or discouraging types of behaviour that the merged entity may engage in to limit or restrain competition e.g. requiring customers to enter into long-term and/or exclusive contracts; creating switching costs for customers through, for example, volume discounts, contractual penalties or requiring complex switching procedures; bundling or tying the sale of particular products; and selective discounting or predation.[10] In the context of the Merger Remedies Review CFE the CMA also gives prominence to "*investment commitments from the merged entity that stimulate competition in a way that achieves long-lasting market change*".[11]

19. We would be cautious of the adoption of "enabling measures" on a stand-alone basis to resolve horizontal concerns, especially where they do not fundamentally change the incentives of the Merged Entity to compete. We understand that some of these enabling measures are however designed to change the structure of market and affect the merged entity's post-merger incentives to compete, and a recent and prominent example of this[12] is the use of investment commitments which, once delivered, is expected to be non-reversable and therefore capable of changing the merging parties' incentives to compete.

20. Whilst we agree that investment commitments which alter incentives (e.g. by reducing marginal costs) represent an improvement over attempting to control market outcomes, they still come with potential risks.

21. First, by definition, they require investment that would not be optimal for the merging parties to make without some regulatory commitment and therefore require the Competition Authority to specify the scope and nature of the commitment. This carries many of the specification risks associated with behavioural remedies (and described above), including how to capture all the dimensions relevant to the competitive process. For example, how do you ensure that they will increase capacity but will not decrease levels of quality where this is a relevant parameter of competition, or that the chosen increase in capacity will lead to a sufficient reduction marginal cost reduction to eliminate the SLC?

22. Second, investment commitments can take time to implement which may necessitate interim behavioural solutions to control market outcomes as and until the investment is delivered. These raise many of the same remedy scope complications discussed above in the context of (horizontal) behavioural controls, albeit in circumstances where there should at least be a clear date at which they can be withdrawn.

23. Third, the investment commitments may themselves become ineffective at maintaining the parties' incentives to compete over the longer term. This may be because the investment itself has a shelf-life and would need renewing, or the market is one which is subject to increasing demand and/or technological change and therefore require a new set of investments in the future.

9 CMA 87, Paragraph 7.12.

10 CMA 87, Paragraph 7.27.

11 Merger Remedies Review CFE, Paragraph 30.

12 See Vodafone/Three, CMA Final Report.

24. Finally, the remedy (including any interim behavioural remedies) will need monitoring to at least the point at which the investment commitment is delivered, and potentially for longer if there are elements of the investment (e.g. quality) which the merged entity is capable of flexing. There may be a need for further involvement by the CMA if additional investment commitments are required down the line.

25. Nevertheless, we see their appeal in situations where the CMA/Parties have confidence that the relevant investment(s) will address the SLC, and are clear cut (i.e. can't be undermined via a reduction in quality or other competitive parameters) and the only residual concern is the Parties may not have an incentive to implement the level/scope of investments that are necessary. In these circumstances a remedy to enforce and police the investment could provide better outcomes than the outright blocking of a merger, dependent on the level of efficiencies. We would expect that investment remedies should be used sparingly and only in specific contexts where they are liable to be timely, effective, long-lasting, and hard to circumvent, for example when the investment is irreversible (e.g. opening a new plant or initiating a program) and will change the merged firm's incentives for the foreseeable future.

2.3. Changes to structural remedies within horizontal mergers could still provide some benefits

26. While we see a relatively narrow role for behavioural remedies to play in horizontal mergers, we believe that some relatively minor reforms in the role that structural remedies play in horizontal mergers may still provide a significant benefit to consumer welfare and efficiencies.

27. Specifically, we believe that the current interpretation of a requirement to sell off the entire overlap to address an SLC will often be unnecessarily restrictive and not necessary to solve the SLC. This is particularly the case in retail mergers where increased competition from online retailers with lower cost bases, has led to a drive for bricks and mortar retailers to reduce their fixed costs by spreading them over a larger retail estate.

28. Currently in retail mergers, the CMA practice is to first determine whether there is an SLC in a given local area on the basis of some local threshold, and, where an SLC is found, require the divestment of the entire overlap within the SLC to rectify that SLC. This however can lead to instances where the Parties are required to divest many more retail stores than is required to solve the SLC, jeopardising the efficiencies of the merger and the merger rationale. For example, in Phase I, if the CMA was to consider that any area in which the merger had the effect of reducing competition from 5 retail fasciae to 4 retail fasciae (or less), was a SLC, then by definition any area that post-merger retained more than 5 independent retail fasciae would not lead to an SLC. Logically, therefore, in order to solve the SLC, the remedy only needs to ensure that are still 5 independent retail fasciae in the market post-merger. In such a case, if each of the Parties had two stores in that local area, it would only need to sell one of the stores to a competitor to solve the SLC and restore effective competition. Requiring the selling off of the entire overlap (i.e. two stores), would be disproportionate to restoring effective competition (and may well jeopardise the economics of the transaction).

29. The same applies to the usage of local market share thresholds in Phase 1 mergers. For example, if the CMA sets a market threshold at 25%, thus finding that there is not a realistic possibility of an SLCs below that threshold, then logically the remedy only needs to ensure that post-merger the Parties in each local area have less than a 25% share in each area.

Given that there is no realistic possibility of an SLC below 25%, forcing the Parties to divest the entire overlap would seem disproportionate to the SLC that is found.

30. We note that in principle this argument about the appropriate approach to structural remedies should also apply more widely than retail mergers. For example, to the extent that the CMA is concerned that one firm may have too much factory capacity of a particular good, then it should not necessarily be required to divest the entire overlap – but rather divest the level of capacity required to ensure that there is no SLC. We do however acknowledge that retail mergers are particularly suitable given that the CMA often uses conservatively set thresholds on which to determine an SLC, and therefore a requirement to sell down to that threshold is likely to be easier to implement.

31. We also note that this reform would be particularly applicable to Phase I remedies for two main reasons.

- First, in Phase II, we understand that the CMA does not generally require the entire overlap to be divested. For example, in Coral/Ladbrokes, the Parties sold down to the required threshold rather than the entire overlap. However, this inconsistency between Phase I and Phase II could lead to mergers being unnecessarily referred into Phase II, simply because the Parties cannot offer the exact set of remedies in Phase I, that would be accepted in Phase II. Given the extremely high expense of a Phase II investigation, in terms of CMA resources, the Parties resources, and the high level of distraction from the day to day running of the business, this is clearly inefficient.
- Second, we do not agree with an argument that, because the Phase I threshold is lower than the Phase II threshold, one should be forced to divest the entire overlap in Phase I. In fact, we consider that the difference in the threshold standards means that being forced to sell off the entire overlap is particularly redundant in Phase I. In Phase I, the threshold to find an SLC within Phase I is purposefully set lower than in Phase II, with the CMA only needing to consider that there is a 'realistic possibility' of a SLC (rather than an SLC is more likely than not). This means that the competition level thresholds used in Phase I are highly conservative, such that below the CMA's threshold, there is, by definition, no realistic possibility of an SLC. This means that the CMA can be highly confident in Phase I that remedying down to a given threshold will ensure that no SLC will emerge, and hence there is no need to sell further stores beyond this threshold.

32. Finally, any remedy, regardless of whether a requirement is made to sell down to the threshold or the entire divestment, should still be subject to a requirement that the purchaser of the remedy will be an effective competitor post-merger. We fully acknowledge that this will mean that there may, depending on the facts of the case, be some instances where a competitor may require a minimum size of estate in order to effective. Depending on who the buyer is, in these specific circumstances it may be appropriate to require a package of divestments that go beyond the level needed to reach the SLC threshold. However, the issue of whether a purchaser is effective should be considered separately from the extent of the divestments.[13]

13 Specifically the CMA should first consider what remedies are required to address the SLC, and only then whether the purchaser of those remedies will be an effective competitor.

3. EFFICIENCIES

33. We welcome the CMA's intentions to review their current approach to efficiencies (rivalry enhancing efficiencies and relevant customer benefits). In what follows we make a number of suggestions based on our collective experience, which we suggest the CMA might usefully consider to improve incorporation of efficiencies into their analysis.

3.1. The CMA should provide more prominence to efficiencies in order to solve the current 'chicken and egg' situation

34. We consider that there is currently a 'chicken and egg' issue within the articulation of efficiencies as part of the CMA merger process. In our experience, Merging Parties do not want to invest significant budget and time articulating and evidencing the existence of merger related efficiencies if they expect that ultimately, the CMA will ignore them or interpret the emphasising of efficiencies as the Merging Parties having a lack of faith in their main arguments concerning the extent of any SLC. However, we also understand that, without well-articulated efficiency arguments which are both quantified and evidenced, the CMA will be unable to take account of them in a merger process.

35. In our view this has led to a bad equilibrium in which the Parties don't believe the expense of documenting efficiencies will have an impact on the outcome, and the CMA never sees strong efficiency arguments, and therefore they never have an impact on the outcome, self-reinforcing the Parties' beliefs.[14] To solve this the CMA needs to change Parties perception of efficiencies and their significance to the CMA merger process.

36. Whilst there is no easy way to do this, we consider it would be productive for the CMA to send a signal to the wider world that it takes efficiencies seriously: this could be in any revised guidance. Ultimately, however, it needs to be supported by the CMA's actual decisional practice, for example calling out and accepting the relevant efficiencies in merger cases, even in circumstances in which a consideration of efficiencies did not ultimately lead to clearance or a change in remedy selection. As discussed in the next sections, this could involve being more receptive to contemporary evidence on efficiencies, and less reliant on theoretical constructs to argue that efficiencies are not merger specific and therefore cannot be considered.

37. Finally, as a more general point, we would also suggest the CMA should be cautious in how it factors any quantification of efficiencies into the SLC threshold, as this too may have a chilling effect on Parties willingness to come forward and present efficiencies. Specifically, in general the CMA will only block a merger if it finds that there is a ''substantial' lessening of competition, which forms part of the rationale for using thresholds in horizontal mergers rather than simply assuming that any increase in concentration is a lessening of competition and should be blocked. It has also been argued, however, that the thresholds may also incorporate some sort of expectation that many mergers will give rise to unquantifiable efficiencies (including maintaining an efficient market for corporate control). To the extent that the combination of the two gives rise to a particular threshold in an industry, if the CMA was then to significantly depart from that threshold on the basis that the Parties have quantified a merger specific efficiency (and therefore an efficiency 'benefit' to the threshold should no longer be included), there is a risk that this disincentivises the Parties to quantify merger specific efficiencies in the first place.

14 This is a (Perfect Bayes Nash) equilibrium because "off the equilibrium path" beliefs are not tested.

3.2. Valuation models and synergies should be given significantly more weight as an evidential source for quantifying efficiencies

38. Within the context of mergers, the CMA now regularly scrutinises the valuation and synergy models to ensure that the underlying assumptions within these models are consistent with what the Parties are telling the CMA. For example, the CMA will often consider the predictions that a valuation model makes in terms of market growth, or the potential for new entrants. Similarly, the CMA will consider whether any valuation may have an assumption of an SLC 'baked' into the valuation in terms of significant price increases, or restrictions of access to products to downstream rivals. We agree that the CMA should be considering these documents, and we also agree that these documents and models provide useful evidence with respect to the consideration of the impact of the merger.

39. To date however, in our view the CMA has significantly underplayed the usefulness of valuation and synergy models in terms of providing evidence to quantify efficiencies. To the extent that these models provide significant evidential weight with respect to the potential existence of an SLC, they can also provide significant evidential weight with respect to the potential existence of significant efficiencies.

40. We understand that the CMA may have a concern that, whilst it can rely on the truthfulness of valuation documents in the context of showing an SLC, it may be less appropriate in the context of efficiencies that may result in the clearance of a merger. Specifically, the CMA may have a concern that if the Parties know that the CMA will consider the valuation documents as evidence of efficiencies to clear the merger, the Parties may overstate or inflate the efficiencies in order to gain clearance. In our view, however, the risk of valuation efficiencies being drafted for a CMA audience may be exaggerated. This is because the synergy quantifications are a key input into shareholders' decision making and the company is subject to a number of check and balances to ensure that any estimates are the best available given the information/data or, if anything, conservative.[15]

41. This is particularly the case in publicly owned companies. For example, in a recent report by PWC for the National Audit Authority, it is made clear that there are number of disclosure requirements on synergies to ensure their accuracy.[16] These include a fiduciary duty of care that Boards of Directors have in ensuring that that due diligence is carried out on target organisations before recommending an offer for an acquisition or merger to shareholders. Furthermore, where a UK public limited company is subject to a non-cash competitive takeover bid, then the Takeover Panel applies rules in order to protect shareholders – through ensuring a consistent, robust and objective process of information reporting around the financial terms of the deal, including synergies, to maintain transparency.

42. Indeed, the report states that *"Where synergies are disclosed in a shareholder prospectus or circular, then a high degree of support to justify the expected benefits is required and an appropriate degree of prudence must be exercised, resulting in contingencies being made within the estimates to reflect uncertainties and risks. The quality and extent of support*

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15 Indeed, it is important to note that the fact that a company has not quantified the efficiency in its valuation model does not mean that the synergy does not exist. This is because in most cases companies only need to evidence the minimum level of synergies needed to show that their valuation is good value for shareholders.

16 *Reorganising central government. Synergy reporting for Mergers and Acquisitions*, a PWC report for the National Audit Authority, March 2010. See also "*Part III, C: Synergy and stand-alone cost-saving statements in capital markets transactions*" Institute of Chartered Accountants in England and Wales, Guidance for Preparers of Prospective Financial Information.

needed if revenue synergies are to be published is particularly high."[17] The report goes onto state that revenue synergies such as cross selling are typically harder to quantify than cost synergies, and therefore are subject to a higher level of contingency.

43. All of this is evidence that the Parties are subject to specific responsibilities in the quantification of synergies and cannot simply inflate them for the purposes of gaining clearance, particularly when they have been published. In such a situation we consider that the CMA should generally treat the level of synergies represented in published statements as an important input into their assessment and in doing so, take into account the assumptions (including level of contingency) on which the estimates have been prepared. The CMA should only supplant these business views with its own view if there is strong evidence that the assumptions are incorrect.

3.3. The CMA should be cautious of where it sets the bar for efficiencies in vertical and conglomerate mergers or in using efficiencies as a theory of harm

44. One result of the CMA Merger Guidelines has been to create a perception that the CMA is sceptical of the benefits of non-horizontal mergers. As we previously commented, the prior guidance was more supportive of the view that, in general, vertical and conglomerate mergers were more likely to be efficient and less likely to be harmful than horizontal mergers.[18] With the more recent update to the Guidance, we believe that the CMA has created a perception of being significantly more sceptical about vertical and conglomerate mergers, not only in their terms of potential harm but also in their term of potential efficiencies. Whilst we agree that the CMA may well have wanted the view that non-horizontal mergers can generate harm, we believe that a general scepticism with respect to the efficiencies that non-horizontal mergers generate is less warranted.

45. On the contrary, a more sceptical view on potential harm from non-horizontal mergers would be only consistent with their potential efficiencies being larger. This is because in a non-horizontal merger both the (static) incentive to raise rivals' cost and the elimination of double marginalisation effects are driven by the same mechanism (i.e. internalising merger partner's margin).[19] In contrast, in horizontal mergers the theory of harm and efficiencies are not inherently linked, and incentives to increase price due to internalisation of competition between the merging parties and incentives to reduce price due to efficiencies (e.g. a reduction in production costs) arise independently of each other and therefore can be assessed separately.

46. Given that even non-horizontal mergers that raise competition concerns will still realise efficiencies, the CMA should be highly cautious before finding that these efficiencies could

17 *Reorganising central government. Synergy reporting for Mergers and Acquisitions*, a PWC report for the National Audit Authority, March 2010.

18 Response to Call for Information to supplement or revise the MAGs for assessing mergers in digital markets. Matthew Bennett, Simon Chisholm. https://assets.publishing.service.gov.uk/media/5f60dab38fa8f51063ce4e8e/CRA_-_Response_to_CMA_call_for_information_-_Digital_Mergers.PDF

19 A higher margin makes an incremental sale generated by raising rivals' costs more profitable but also makes elimination of double marginalisation larger as a larger margin is eliminated.

be achieved by plausible less anti-competitive alternatives to the proposed merger.[20] Specifically the CMA should be mindful of making broad sweeping statements regarding the ability for the Parties to replicate efficiencies through some sort of theoretical contractual solution. In general, it will be difficult to write complete contractual solutions, and the absence of such contractual solutions in the market will generally be a strong indicator of the lack of suitability of such solutions to replace a merger.[21]

47. Finally, if deeper analysis of efficiencies is to be integrated into merger control, the CMA should be wary of using efficiencies as an 'offense' – using evidence of them to block a merger. Whilst we agree efficiency offenses are theoretically possible, the danger of treating an efficiency as a potential risk to competitors, even if the CMA ultimately does not block the merger on that basis, is that the Parties and advisors become more wary about raising and evidencing efficiencies. The concern is that it may lead to significant questioning by the CMA, delaying the time to go on the clock and increasing the Parties' costs. As such we consider that the CMA should be generally cautious about giving too much weight to efficiency offense theories, and where they have considered them but rejected them, the CMA should make it clear in the decision that ultimately it considered the efficiencies as a significant benefit to consumers – not as a potential risk to competition.

20 In the context of vertical mergers, the Merger Remedies Guidance notes "*Vertical mergers may generate efficiencies that could potentially result in benefits to customers, such as lower prices, improved quality or greater innovation, even when the merger also substantially lessens competition. Examples include improved coordination, for instance, in marketing and product design between firms at different stages of the supply chain; lower transaction and inventory costs; and removal of possible 'double marginalisation' that may occur when two non-integrated firms both have significant market power. However, as for all RCBs, it would be necessary for the CMA to be satisfied that these effects could not be achieved by plausible less anti-competitive alternatives to the proposed merger.*" CMA 87, Paragraph 3.24. In the context of vertical mergers, the Merger Assessment Guidance notes "*In the case of vertical mergers, alternative means to achieve the reduction of double marginalisation include contractual agreement and non-merger expansion along the supply chain.*" CMA 129, Paragraph 8.18.

21 For example, an efficient two-part tariff to eliminate double marginalisation in a vertical supply chain would require the downstream Partner to trust that the upstream Partner would not offer similar deals to its downstream rivals. However, if such trust is possible then a raising rivals cost strategy can also be implemented by the upstream Partner raising input price unilaterally and agreeing to a two-part tariff contract with the downstream Partner who would obtain a lower price by paying a fixed fee.