

RESPONSE OF CLIFFORD CHANCE LLP TO THE MERGER EFFICIENCIES REVIEW: CALL FOR EVIDENCE OF THE COMPETITION AND MARKETS AUTHORITY

Clifford Chance LLP welcomes the opportunity to respond to the Merger Efficiencies Review: Call for Evidence of the Competition and Markets Authority (**CMA**). Our comments below are informed by our experience advising on merger control proceedings in the UK and other jurisdictions. However, the comments in this response do not necessarily represent the views of our clients.

1. THEME 1 (A): THE CMA'S FRAMEWORK FOR ASSESSING EFFICIENCIES

1.1 The current Merger Assessment Guidelines (**MAGs**) specify that rivalry enhancing efficiencies must, if they are to be taken into account:

1.1.1 enhance rivalry in the supply of those products where an SLC may otherwise arise;

1.1.2 be timely, likely and sufficient to prevent an SLC from arising;

1.1.3 be merger-specific; and

1.1.4 benefit customers in the UK.

1.2 We consider that this framework remains broadly correct. Indeed, in some respects, the CMA's framework is superior to that of the European Commission, as it allows the CMA to take into account out-of-market efficiencies (albeit seemingly only in the consideration of remedies and Phase 2 referrals, under the separate test for relevant customer benefits)¹ and recognises that the test for merger-specificity is essentially a counterfactual analysis.

1.3 However, our view is that the CMA has, in many other respects, interpreted these conditions too restrictively, with the result that it has only rarely cleared a merger unconditionally on the basis of rivalry-enhancing efficiencies.² This has led to a widespread belief among businesses and their advisers that it is futile to spend the considerable time and resources required to

¹ Paragraph 8.9 of the current MAGs state that "[b]ecause the CMA has a duty to consider whether a merger will lead to an SLC in a market [...] efficiencies need to enhance rivalry in a way that counteracts the effects on competition identified in the SLC assessment". However, footnote 129 adds that efficiencies "do not only need to affect the market which is the subject to the CMA's SLC assessment. For example, R&D efficiencies may affect multiple markets". We do not understand this footnote to mean that the CMA will take into account out-of-market efficiencies that do not enhance rivalry in the market in which an SLC would otherwise arise, but suggest that this is clarified in the revised MAGs.

² It has done so in Phase 1 (see our comments at 1.16 below) and it has cleared a Phase 2 case unconditionally on the basis of relevant customer benefits, rather than rivalry enhancing efficiencies (in its Final Report on the *Anticipated merger between Central Manchester University Hospitals NHS Foundation Trust and University Hospital of South Manchester NHS Foundation Trust*).

prepare and submit evidence of rivalry-enhancing efficiencies, even if there is a compelling case for them.

- 1.4 The current MAGs, and the current call for evidence, recognise that rivalry-enhancing efficiencies can have the effect of “offsetting any anticompetitive effects” of a merger (see paragraph 9 of the call for evidence). That being so, an unduly or disproportionately restrictive approach to rivalry-enhancing efficiencies is counter-productive: it necessarily deprives the economy of such pro-competitive effects, which is inconsistent with the CMA’s statutory duty to promote competition for the benefit of consumers, as well as being inimical to much-needed improvements in UK productivity, itself a key component of economic growth.
- 1.5 To address this, the section of the MAGs that deals with efficiencies should be considerably expanded, with more detailed guidance on the CMA’s approach to assessing efficiencies. Moreover, in a number of areas – which are identified below – they should be revised to reflect better the broad range of scenarios in which efficiencies may arise, and the supporting data that can feasibly be expected to be available. In particular – and in line with the “predictability” element of the CMA’s 4Ps framework – it would be an enormous advance if the MAGs were updated to provide much more detail of the evidence that the CMA will accept to substantiate efficiencies. The current lack of guidance has meant that, in cases in which evidence of efficiencies has been presented by the parties, the CMA has invariably found fault with it.

Rivalry-enhancing effects and pass-on

- 1.6 The MAGs state that the CMA “will generally view reductions in the merger firms’ marginal or variable costs as being more likely to result in an incentive to reduce price or make short-run improvements in quality than reductions in fixed costs”, but that fixed cost savings “may enhance the ability of firms profitably to innovate or invest in entry or expansion”.³
- 1.7 The *Vodafone/Three* case shows that this distinction between marginal and fixed costs is an oversimplification and fails to recognise that efficiencies affecting fixed costs can significantly boost long-term competitive outcomes through their impact on decisions around investment, market entry, and capacity. In *Vodafone/Three*, one of the most significant rivalry-enhancing efficiencies resulted from reductions in the incremental unit costs of adding additional capacity,⁴ which would ordinarily be considered a fixed cost, but which incentivised investment by the merging parties that would not otherwise have been cost-effective. The MAGs should therefore recognise that:

³ Paragraph 8.10 of the MAGs.

⁴ See *Final Report in the Anticipated joint venture between Vodafone Group Plc and CK Hutchison Holdings Limited concerning Vodafone Limited and Hutchison 3G UK Limited*, paragraph 14.25

- 1.7.1 if a merger enables the combined entity to build new production capacity at lower capital cost, the resulting fixed-cost savings can enable expansion that would not otherwise have been feasible;
- 1.7.2 access to intangible fixed assets, such as new intellectual property or technical expertise, may allow the merged firm to produce at a larger scale or at higher efficiency; and
- 1.7.3 in such cases, the distinction between fixed and marginal costs is not rigid and may depend on the timeframe within which the expected efficiencies are anticipated to arise.

Balancing competitive benefits and harms

- 1.8 In our view, the CMA's consumer welfare framework for assessing efficiencies under the EA02 is sufficiently flexible to accommodate the fact that efficiencies may relate to different parameters of competition than those adversely affected by the merger, or may arise in different time periods.⁵ Where a merger will give rise to a short-run price increase, but also (due to increased innovation or investment) longer term improvements in product quality, the net impact of these effects can be assessed by balancing the magnitude of the price increase against the value of the expected improvements to consumers, which can be measured subjectively (e.g. by reference to "willingness to pay" surveys) or, in appropriate cases, objectively (e.g. through quantification of avoided environmental harms).
- 1.9 Similarly, the quantum of benefits and harms can be adjusted to reflect the fact that they will arise in different time periods, e.g. taking into account factors such as the degree of uncertainty that they will arise and the time value of money. In this respect, the current MAGs seem to imply that efficiencies must be realised in the same timeframe as that in which the CMA has assessed competitive harm.⁶ If this is the intended meaning, we disagree that it should be a pre-condition for the acceptance of rivalry-enhancing efficiencies that they arise in the same time period, as that would be inconsistent with the way that the CMA assesses other countervailing factors. For instance, the MAGs state (paragraph 8.33) that "entry or expansion being effective within two years of an SLC arising would be considered by the CMA to be timely" – yet we note that the Competition Commission cleared *Zipcar/Streetcar*

⁵ In particular, s.35(1) and 36(1) EA02 provide that the question to be decided is whether the merger may be expected to result in an SLC within any market or markets in the UK for goods or services, without making any distinction between different parameters of competition or time frames.

⁶ Paragraph 8.12: "*The CMA will assess whether the claimed efficiencies are to be realised (and the resultant rivalry-enhancing effects felt) within the same timeframe as the CMA has adopted in the rest of its analysis.*"

unconditionally, despite the fact that it expected prices to rise in the short term, because it found that new entry was likely to constrain pricing "within a few years".

- 1.10 As regards the factors that the CMA should consider when assessing the appropriate timeframe for efficiencies to be considered "timely", our view is that the only relevant factor is that of likelihood, i.e. the timeframe in which it can be assessed that the relevant efficiencies are likely to arise, on the balance of probabilities.
- 1.11 We recognise that the allowing a merger on the basis that longer-term benefits outweigh the harm of short-run price increases may place the CMA in an uncomfortable position, given the possible perception of consumers that the CMA has allowed a merger that gave rise to price increases. However, the concept of rivalry-enhancing efficiencies is meaningless if the CMA invariably recognises such efficiencies only under the framework for relevant customer benefits in the assessment of remedies and insists on price controls to limit short term price increases and commitments to "lock in" the expected rivalry enhancing efficiencies. Where there is good evidence that longer term benefits will outweigh short term harms, the CMA must be prepared to communicate those benefits actively to the public and to advocate in favour of the merger, once cleared. For the CMA to shy away from doing so would deprive consumers and the economy of potentially important pro-competitive improvements and productivity gains - which, again, would be antithetical to the CMA's duty to promote competition, as well as undermining necessary steps to enhanced economic growth.

Merger-specificity

- 1.12 Unlike the European Commission, the CMA has, in its decisional practice, applied the correct approach to assessing merger specificity, which is by reference to the likely counterfactual in which the merger does not take place.⁷ However, it should be stated explicitly in the MAGs that the CMA will assess whether the relevant efficiencies would be likely to be brought about in the counterfactual. They should also recognise that it will rarely be the case that the parties will have the incentive to achieve efficiencies, in the absence of the merger, through horizontal cooperation agreements, as such agreements give rise to significant competition compliance risks, given that there is no mechanism to obtain formal clearance under CA98.
- 1.13 We also consider that the MAGs should also make it clear that, if a benefit will accrue more quickly than in the counterfactual, the incremental benefit of early implementation is merger specific. In *Microsoft/Activision*,⁸ the CMA appears to have rejected the merger-specificity of benefits from agreements to make content available to rival cloud gaming service providers in

⁷ See, for example, [Vodafone/Three]

⁸ Paragraph 9.76 of the Final Report

the immediate aftermath of the merger on the basis that such content would have been made available in the counterfactual "within five years". In our view, this position was misconceived, as the swifter introduction of these benefits was liable to bring forward the development of the nascent cloud gaming services market by a number of years.

Efficiencies "offence"

- 1.14 In two cases that we advised on, the CMA considered whether the efficiencies that would be generated by the merger would *harm* competition: through a margin squeeze resulting from lower backhaul costs (in *BT/EE*), and through being able to undercut rivals as a result of procurement efficiencies (*Tesco/Booker*). While those theories of harm were ultimately dismissed, the fact that they were given credence by the CMA adds to the various factors that dissuade merging parties from raising valid efficiency arguments (see also our comments at 1.3 above).
- 1.15 We submit that the revised MAGs should contain a clear statement that the CMA will not entertain "efficiency offence" theories of harm where the relevant efficiencies act only to improve the competitive offering of the merging parties. It is, in our view inimical to the purpose of the merger control regime to consider prohibiting a merger on the basis that it creates benefits for consumers, even if rivals may be unable to match those benefits.

Rivalry-enhancing efficiencies in Phase 1 cases

- 1.16 The current MAGs state that, at Phase 1, "the evidence must be sufficient to satisfy the CMA within the time available in an initial investigation that efficiencies would prevent the realistic prospect of an SLC."⁹ Requiring the parties to demonstrate that efficiencies will prevent any realistic prospect of an SLC (i.e. prospects that are greater than fanciful) is a high bar and is likely to deter parties from raising efficiency arguments in Phase 1. To mitigate against this, the revised MAGs should include a reference to Phase 1 cases in which the CMA and the Office of Fair Trading (**OFT**) have considered rivalry-enhancing efficiencies in Phase 1 and, in particular, the *DPG/Zoopla* decision,¹⁰ in which the OFT cleared what was effectively a 3-to-2 merger of the second and third largest online property portals, on the basis that it gave rise to rivalry-enhancing efficiencies in the form of network effects that would allow the merged entity to become a credible competitor to the market leader.

⁹ Paragraph 8.15 of the MAGs.

¹⁰ *Anticipated merger between The Digital Property Group Limited and Zoopla Limited*, Case ME/5233/1, 16 April 2021.

2. **THEME 1(B): THE EVIDENCE BASE**

2.1 The MAGs state that many efficiency claims by merging firms are not accepted by the CMA because the evidence supporting those claims is difficult to verify and substantiate, noting the difficulty involved in accepting prospectively that a merger is likely to lead to efficiencies. In our view, there are also other factors that can contribute to the rejection of evidence by the CMA:

- 2.1.1 lack of guidance: while it is correct that the merging parties typically hold much of the evidence to substantiate the efficiencies resulting from a merger, they often do not know which evidence the CMA will find useful or persuasive. This creates a risk that the CMA rejects synergy analyses submitted by the parties as being flawed or insufficient, when there is other, different evidence available that the CMA would have found more useful. In addition to more detailed guidance in the MAGs, case teams should be prepared to give merging parties up-front guidance on the evidence that they should submit to substantiate the specific types of efficiencies that the merging parties expect to arise (see also our comments at 4.2 below);
- 2.1.2 ignoring or downplaying useful evidence from third parties: in cases where parties have submitted evidence of efficiencies, the CMA should routinely assess whether any third-party evidence – to which the parties do not have access – may be probative, e.g. evidence from customers/consumers regarding the value that they place on innovation or investment efficiencies, or evidence from parties to previous mergers in the same sector;¹¹
- 2.1.3 CMA scepticism: the current MAGs state that "studies have found that firms often do not fully realise the expected synergies from their mergers". This implies that the CMA's starting point is that merging parties' submissions regarding their synergies are likely to be wrong or excessively optimistic. We suggest removing this implied assumption. When parties' boards of directors have committed to spend substantial resources on a merger and, in doing so, have relied on synergy analyses, internal business plans, financial records, integration documents and R&D plans, they have every incentive to make sure that their analyses are correct and based on accurate information. Again, such a presumption against having regard to pro-competitive efficiencies is hard to reconcile with the CMA's duty to promote competition, and with the imperative to enhance economic productivity and, hence, growth.

¹¹ As the CMA did in *Sainsburys/Asda*.

- 2.2 Further, given the inherently prospective nature of merger control, efficiencies – particularly dynamic efficiencies relating to innovation, investment, R&D – almost inevitably require longer timeframes to materialise, in line with investment and innovation cycles which are sector- and case-specific. The CMA's approach to assessing efficiency claims needs to reflect the practical realities of the sector in which the parties are active.
- 2.3 In turn, the CMA should remain open to considering a wide range of evidence when assessing rivalry-enhancing efficiencies, with the nature (quantitative or qualitative) and extent of evidence varying by the type of efficiency claimed.
- 2.4 Where the efficiencies appear to be more direct and measurable, quantitative evidence should be expected; whereas for more long-term efficiencies, qualitative evidence should be given greater weight. The MAGs should provide clarity on what might constitute sufficient evidence to assist the CMA in evaluating efficiency claims.

3. **THEME 1(C): DYNAMIC EFFICIENCIES AND INNOVATION**

- 3.1 It is clear from economic literature that mergers can give rise to very substantial efficiencies relating to dynamic innovation. However, the current MAGs refer only in passing to the possibility of efficiencies of this nature and give no guidance on the evidence that the CMA will expect to substantiate such efficiencies, or how it will deal with the complexities that are inherent in assessing such efficiencies, e.g. regarding the lack of certainty that they will arise and the quantification of the wide variety of benefits to which they may give rise. The CMA's review of its approach to assessing merger efficiencies presents an opportunity to remedy this deficiency.
- 3.2 While there are various ways in which mergers may enhance innovation or dynamic competition, four that appear to us to be most important are:
- 3.2.1 sharing of innovations between the merging parties. When merging parties are able to share the results of their R&D and benefit from each other's successful innovations, this increases their incentives to invest in R&D;
- 3.2.2 market expansion, which may occur when innovations boost overall demand. Game-changing innovations may even create entirely new markets, with spill-over benefits for other players that enter or supply those markets. Sharing knowledge through a merger can amplify this effect. We recognise that if spillover effects affect or create other markets than the one in which there is a reduction in the number of competitors, it will often be more appropriate to assess such effects as a form of RCB, but submit

that they should also be considered rivalry-enhancing if they benefit substantially the same customer base;¹²

- 3.2.3 internalisation of spillovers, where mergers help parties to appropriate more benefits from their innovations by reducing knowledge leakage to competitors, so strengthening innovation incentives; and
- 3.2.4 mergers in multi-sided markets that enhance the network effects of the merged entity, allowing it to compete more effectively with a market leader (e.g., if the market is prone to tipping in favour of the market leader absent the merger).
- 3.3 We recognise that assessing and quantifying these benefits and balancing them against harms resulting from a reduction in the number of competitors can give rise to difficult issues. For instance, if it can be established that a merger will increase investment in R&D, it will often be impossible to establish that those R&D efforts will succeed (and so bring benefits to consumers), on balance of probabilities. However, the CMA regularly identifies harm to competition on the basis of a reduction in *potential* competition, e.g. through the discontinuation of pipeline pharmaceutical products that had only limited prospects of making it through Phase 2 clinical trials.¹³ The same principle should apply when assessing competitive benefits arising from increased innovation, i.e. it is not the likelihood of successful innovation that is important, but the increased *potential* for successful innovation. Indeed, recent economic research indicates that, in cases where the parties' respective innovation efforts are directed to a potential game changing innovations, mergers between competitors tend to increase the likelihood that game changing innovations are realised where the prospects of success are particularly *uncertain*.¹⁴
- 3.4 As regards spillover benefits of a merger that improve the offering of competitors, we have reservations about the position expressed in *Microsoft/Activision*¹⁵ that benefits that accrue to "select" market participants are not rivalry enhancing, "even if these participants were to account for a large portion of the market". While we recognise that such selective benefits may give rise to market distortions, that should be balanced against the positive effects of

¹² Consistent with the CMA's approach in relation to horizontal sustainability agreements – see Green Agreements Guidance (CMA185), paragraph 5.21.

¹³ It has been estimated that, on average, only one to two of every 10,000 substances synthesised in laboratories will successfully pass all stages of development required to become a marketable medicine, and that the overall success rate of Phase 1 clinical trials is only 6.7% (and only 14.6% for Phase 2 trials) (see C Lammens, "Pharmaceutical Innovation in EU Merger Control: (Ir)reconcilabilities Between Legal Idealism and Economic Reality" (2019), available at <https://ssrn.com/abstract=3481742> .

¹⁴ See "The Effect of Mergers on Innovation" (2025), Das, Mayskaya & Nikandrova, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4343673

¹⁵ Paragraph 9.81 of the Final Report relating to the original transaction.

stimulating the competitive responses of those market participants that do benefit. It should not be a reason to dismiss the rivalry-enhancing nature of such benefits and to refuse to carry out a balancing exercise.

4. **THEME 2: THE CMA'S PROCESS FOR ASSESSING RIVALRY-ENHANCING EFFICIENCIES**

4.1 The MAGs should include a clear statement that parties can raise efficiency arguments on a without prejudice basis and that, in any event, raising these arguments will not be seen as a concession that the merger gives rise to an SLC that must be counteracted by efficiencies. We think it highly likely that these considerations have a "chilling effect" on parties raising the issue with the CMA - which is inimical to the CMA having a chance to engage with pro-competitive and productivity-enhancing opportunities of such efficiencies.

4.2 The CMA in its decisional practice has demonstrated a willingness to engage with parties on efficiency claims through written submissions, meetings, and requests for further information, albeit the claims are rarely accepted due to a lack of robust, merger-specific evidence, despite extensive engagement. For merging parties, the evidential bar can therefore seem high and the process somewhat inflexible, particularly when it comes to evidencing complex efficiencies. There are various practical steps the CMA could take to improve this process going forward:

4.2.1 in addition to the CMA signalling willingness to engage in collaborative early-stage discussions on efficiencies on a without prejudice basis, clearer guidance on evidential standards, and greater openness to a mix of qualitative and quantitative evidence would be meaningful changes to the current approach;

4.2.2 allowing for early, informal discussions of efficiency claims to help parties focus their efforts; and

4.2.3 holding a technical workshop with the parties at an early stage in Phase 2, to provide a steer on the type and extent of evidence the CMA would need to receive from the parties (based on the Phase 1 decision) to be able to favourably consider efficiency claims. This will allow the parties to decide relatively early whether they are likely to be able to provide sufficient evidence and therefore whether this is an avenue they should pursue or simply focus on their other submissions.