

Merger efficiencies review: call for evidence

Response on behalf of Herbert Smith Freehills Kramer LLP

This response to the above open call for evidence is submitted on behalf of Herbert Smith Freehills Kramer LLP. The comments set out below are those of Herbert Smith Freehills Kramer LLP and do not represent the views of any individual client. Please note that we answered only certain of the questions set out in the call for evidence.

Theme 1 (a): The CMA's framework for assessing efficiencies

Q1. Is the CMA's current framework of requiring efficiencies to be rivalry-enhancing, timely, likely and sufficient, merger-specific, and benefit UK customers appropriate? If not, please explain why and how the CMA's framework should change.

- We broadly agree with the current framework but consider that the way it is applied should be reviewed. In particular, the evidential threshold for meeting the test should be re-evaluated. A pragmatic approach should be taken in considering what is 'merger-specific': efficiencies should not be disregarded on the basis that the regulator considers there is another hypothetical way to achieve the efficiencies even when the parties, for legitimate commercial reasons, would not go down that route. In applying the framework, it should be interpreted broadly so that out-of-market efficiencies and broader public interest and economic policies can be taken into account. Furthermore, it ought to be applied in a flexible and pragmatic way appropriate to the particular market and parties concerned.

Q2. Is the CMA taking an appropriate approach when assessing whether efficiencies are rivalry-enhancing, timely, likely and sufficient, merger-specific and benefit UK customers? For example:

- a. What factors should the CMA consider when assessing the appropriate timeframe for efficiencies to be considered 'timely'?**
- b. In assessing sufficiency, how should the CMA balance competitive benefits and harms? In particular, how should the CMA balance competitive benefits and harms when they arise over different time periods or relate to different parameters of competition or groups of customers?**



c. In considering merger specificity, how should the CMA assess whether there are less anticompetitive alternatives to the merger that could achieve the efficiencies in question?

d. How should the CMA assess the extent to which firms are likely to pass-through the benefits of efficiencies to customers? In what circumstances is pass-through likely to occur?

- Overall, we would welcome a more flexible and pragmatic approach to applying the framework for rivalry-enhancing efficiencies together with more detailed guidance on what parties need to show and what evidence the CMA would find helpful in its assessment.
- In considering the appropriate timeframe, we would welcome the revised guidelines incorporating greater flexibility and a recognition that timeliness might differ from sector to sector. The current guidelines¹ have led to a perception that the CMA can be dismissive of efficiencies that take longer to materialise. The CMA's recognition in its Vodafone/Three decision² that a longer term perspective is appropriate in the mobile network sector was welcomed and it would be helpful if the guidelines recognised that how timely is interpreted may vary by sector. The CMA should take a longer term view on balancing efficiencies versus potential harms. It should be possible to offset short term harms in circumstances where there are longer term benefits, in certain circumstances using short-term behavioural remedies to address the risks of such short-term harms.
- Rivalry-enhancing efficiencies are by their nature forward-looking and therefore present challenges when trying to demonstrate likelihood and magnitude. This is particularly the case where the efficiencies are not 'standard' fixed or marginal costs but instead relate to qualitative or innovative improvements (which are arguably potentially more beneficial but also more challenging to quantify). The current guidelines provide that 'merger efficiencies must be likely to be realised.' This has often been perceived as a particularly high bar to meet and greater clarity on the standard of proof would be welcomed. The guidelines give very limited examples of the types of evidence that merger firms may wish to submit.³ Furthermore, the examples referenced in the guidelines and typically accepted by the CMA do not lend themselves to novel or fast-developing areas of the

¹ Paragraph 8.12 Merger Assessment Guidelines provides: *'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. However, usually the longer the time period necessary for efficiencies to be realised, the greater will be the level of doubt that efficiencies will be realised at all.'*

² We note that in Vodafone/Three, the CMA considered that 'investment in mobile networks require a long-term perspective' (see para 14.240).

³ Paragraph 8.13 Merger assessment Guidelines gives only two examples: evidence of efficiencies released from previous mergers and mergers in analogous markets.



market. We would welcome more willingness from the CMA to accept business/investment plans of the parties as suitable evidence – these documents reflect the parties' own views on the benefits of a transaction and should therefore generally be seen as strong evidence. Clarity in the guidance on which types of evidence, such as internal documents in contemplation of the merger or expert reports produced for this specific purpose, would be accepted as reliable evidence by the CMA would be welcomed. Furthermore, the standard of proof required to show efficiencies should be no different from the standard of proof required to show if there is a substantial lessening of competition.

- In assessing whether efficiencies are merger-specific, it is common to hear from businesses that, whilst they could in theory enter into alternative arrangements, this may not be realistic for legitimate business reasons, nor reflective of the actual market dynamics of the relevant market or a credible option for shareholders/investors. As such, we would urge the CMA to take a realistic and pragmatic approach to its interpretation of the 'merger-specific' requirement.
- When balancing competitive benefits and harms, account should be taken of all groups of consumers in the CMA's analysis so that the net position can be considered. If holistically there are substantial efficiencies, it does not make sense to risk losing these on the basis that there is a small set of consumers who would not benefit in the same way.
- We would welcome the CMA taking a broad approach to evaluating the benefit to UK consumers such benefits outside the one where the SLC occurs; benefits for the wider sector ecosystem; wider UK economic growth; or environmental benefits. Such approach should be reflected in the revised guidelines by providing greater clarity and worked examples.

Q3. Are there some transactions which due to their nature or the characteristics of products or markets, are more likely to create efficiencies (for example, whether a merger is horizontal or vertical)?

- We would urge the CMA to consider all mergers on their specific facts irrespective of the sector or nature of the transaction. If the CMA does not take an agnostic approach and instead creates categories of types of transactions that may be more likely to generate efficiencies, there is a risk that transactions that do not fall within such categories are perceived as less likely to generate efficiencies (which may not be the case) and/or transactions being presented to fall within such criteria rather than simply being assessed on their merits.



Theme 1 (b): The evidence base

Q1. What types and extent of evidence should the CMA consider when assessing potential rivalry-enhancing efficiencies? To what extent should this vary across different types of efficiencies?

- There has been some concern that regulatory authorities can be quick to dismiss evidence from parties on rivalry-enhancing efficiencies as such efficiencies are by their nature often difficult to verify and quantify with a high degree of certainty. This can disincentivise parties from putting forward such points. A more flexible and pragmatic approach by the CMA based on what evidence is available and produceable would be welcomed. For example, reports produced by experts and internal analysis produced by the merging parties may still provide valuable insights even when produced in contemplation of the merger.

Q2. What evidence should the CMA use to compare the likely magnitude of claimed efficiencies against the potential adverse effects on competition arising from a merger? What factors should determine the extent to which this assessment is quantitative or qualitative in nature?

- This is highly merger specific and will be determined both by the nature of the CMA's concerns and of the efficiencies. However, in general terms the CMA may need to be willing to accept qualitative arguments in relation to innovation/dynamic markets even if the static harms can be more readily assessed in quantitative terms. Moreover, non-price competition benefits and innovation/dynamic efficiencies tend to lag behind any anti-competitive effects and so should be assessed within a longer timeframe. Consequently, a longer term view may be needed to assess whether the magnitude of any efficiencies offset any adverse effects.

Q3. What types of relevant evidence are held by merging parties, and are there types of evidence they find more difficult to produce? What sources of evidence other than those held by merging parties should the CMA consider?

- This is likely to vary from case to case but is likely to include internal documents, economic reports, and industry reports. Evidence from third parties may also be available.



For example, in some sectors, it may be possible for the CMA to seek evidence or opinions from sector regulators or stakeholders.

Theme 1 (c): Dynamic efficiencies and innovation

Q1. In what circumstances can mergers positively impact the ability and incentives of the merged company to undertake R&D and/or innovate in the relevant products/markets?

- Examples of circumstances where a merger would have a positive impact on the ability and incentives of the merged entity to undertake R&D and/or innovate would be where the merger removes duplication in R&D efforts, brings together complementary R&D facilities and specialisations, allows for the better exploitation of the parties' respective intellectual property rights, allows parties to sustain broader and deeper pipeline (as improved financial resources for R&D and the greater the number of prospects spreads the risk and mitigates high failure rate) and more generally increases parties' ability to undertake R&D.
- In some sectors (e.g., pharmaceuticals) it is not necessarily the case that the merger would result in greater innovation on the relevant products markets about which the CMA has concerns. Given the inherently uncertain nature of some types of R&D (e.g., pharmaceutical development), a transaction may not result in a rivalry enhancing efficiency in the markets which give rise to competition concerns, but it may nonetheless give rise to significant benefits that are beneficial to consumers and the public interest more generally. We would therefore suggest that the CMA explores how to capture such research and innovation gains which benefit the economy or consumers as whole.

Q2. What evidence should the CMA consider when assessing whether a merger will likely increase R&D and/or innovation in the relevant products/markets?

- The CMA should be willing to look beyond just the past behaviour of the merging parties and the narrow scope of the markets which give rise to the CMA concerns. This could involve looking at evidence from the parties and/or third party experts as to their wider R&D capabilities, assets and facilities,

Q3. Are there circumstances in which mergers can foster innovation more broadly across a market or sector? Please provide evidence to support your answer.



- We consider that there can be a wide range of scenarios where mergers can foster innovation more broadly across a market or sector. For example, in sectors where the outcome of R&D is highly uncertain and there is a significant failure rate, to compete effectively (particularly at a global level) it is often necessary to have significant scale, financial resources, research capabilities and/or intellectual property to have a broad and/or deep enough pipeline to generate significant innovative gains.
- By focussing on concerns about particular product-level overlaps relating to parties' R&D pipelines, the CMA potentially misses the wider (and potentially countervailing) benefits of a merged entity's enhanced research and development capacity overall (particularly where the parties' research strengths may be complementary). This can generate benefits which are unrelated to the products which are the focus of the CMA's investigation.
- Particularly in very novel areas of scientific or technological development (which frequently are capital intensive and may require parties to pool resourcing through a merger to enable their delivery) it may be difficult to determine what the ultimate end-use cases of a technology or product may be. This again argues for looking more holistically at the potential benefits for a wider market or sector.
- The above applies most readily to a number of industries and sectors such as pharmaceuticals or computer hardware; however, we believe there are likely to be many other sectors where innovation benefits of a merger may be felt across the wider market or sector. Consequently, any criteria for assessing such benefits should be agnostic both as to sector and merger type.

Q4. To what extent, and how, should the CMA's approach differ between assessing static and dynamic efficiencies (eg with respect to the framework set out in paragraph 11 above)?

- As they are by their very nature, forward-looking, dynamic efficiencies tend to be much less readily verifiable and can be challenging to quantify (particularly given that the often very significant countervailing benefits may take a material amount of time to eventuate). The CMA should be willing to therefore consider a longer timeline in assessing dynamic efficiencies.
- Further, even if the CMA can identify potentially less anti-competitive ways of achieving particular innovative outcomes (e.g., licensing particular IPR), the CMA should robustly test that such counterfactuals are viable in the context of the relevant markets and should



also be willing to weigh such alternatives against any wider R&D gains that could flow from the transaction.

Theme 2: The CMA's efficiencies process

Q1. How effectively does the CMA engage with merging parties on rivalry-enhancing efficiency claims? Are there any ways in which this could be improved?

- We would welcome a willingness to be more pragmatic and accept available evidence on efficiencies. It would also be welcomed if the CMA embedded into its 4Ps approach a means to pro-actively explore with the parties constructive ways in which such efficiencies can be preserved at an early stage of the process.

Q2. What barriers are there to merging parties making and substantiating rivalry-enhancing efficiency claims through the different stages of a case? Are there practical steps the CMA could take to reduce or remove these barriers?

- It would be welcomed if the CMA could consider what steps it could take to credibly test with third parties the robustness of efficiencies. The CMA could also consider practical steps that it could take so that the case team's and decision-makers' views on the SLC question cannot be influenced by any parallel discussions on efficiencies. One way to do this would be invite the parties to raise efficiency points early in the process and to have separate teams working on the two issues in parallel with appropriate safeguards in place.
- Guidance as to the evidence that may be particularly helpful to the CMA, particularly in relation to economic evidence (similar to the EC Economics Best Practice Guide) would be very helpful. Similarly, illustrative examples and case studies that demonstrate the CMA's approach to their assessment and any remedies would be welcomed.

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