

PAUL, WEISS

RESPONSE TO CALL FOR EVIDENCE IN CMA'S MERGER
EFFICIENCIES REVIEW

1. EXECUTIVE SUMMARY

- 1.1 Paul, Weiss welcomes the CMA's call for evidence on this important topic and submits this response to the consultation.¹ The decision to review the CMA's approach to rivalry-enhancing efficiencies ("REEs") is timely in the current environment, with the UK government's growth agenda and the CMA's commitment to the 4Ps.
- 1.2 With the recent and significant exception of the decision in *Vodafone/Three*, historically efficiencies arguments (including on REEs specifically) have rarely been accepted in practice. This is because the CMA's current framework (timely, likely, sufficient, merger specific, customer pass on) involves multiple hurdles and at least in the past, the CMA set a high evidentiary bar for parties to meet for each. In part because of the combination of multiple requirements with a high bar on acceptance, and in part because of the concern that running an efficiencies case implies that the deal involves an SLC, parties can be discouraged from investing time and effort to develop strong REE cases.
- 1.3 The CMA is of course not unique in its approach to merger efficiencies – its framework of timeliness, verifiability and merger specificity is shared by several other competition regimes including the European Commission. These approaches each involve agencies needing to grapple with the uncertainties inherent in a forward-looking assessment, where the level of certainty required to prove the likelihood of efficiencies is often perceived to be higher than that required to prove anti-competitive harm.
- 1.4 The CMA's call for evidence presents an opportunity to consider whether the CMA's current approach to this trade-off is too cautious and not sufficiently able to take account of, and give due weight to, efficiencies, including in the CMA's competitive assessment. This recalibration is particularly urgent in dynamic, innovation-centred markets where an overly conservative approach to merger efficiencies could risk stifling investments and innovations that would benefit UK consumers and the economy as a whole, but is also important for legacy markets that underpin the British economy.
- 1.5 With these points in mind, our key recommendations on the issues raised in this consultation response are:
- (a) **Integrate REEs into the competitive assessment:** REEs should be considered as part of the assessment of a merger's effect on competition, and not as a subsequent step, applying the balance of probabilities standard equally to both consideration of efficiencies and theories of harm.

¹ This response was prepared by Paul, Weiss lawyers Nicole Kar, Lauren O'Brien, Fay Davies, Angus Lane and Natalia Castilla. Paul, Weiss is grateful for the input of Lau Nilausen of Compass Lexecon in preparing this response.

- (b) **Align evidentiary standards symmetrically:** The degree of uncertainty permitted when assessing a theory of harm should be mirrored in the CMA's approach to REEs.
- (c) **Adopt flexible timeframes for timeliness:** The timeframe for assessing efficiencies should vary based on the nature of the claimed efficiencies and align with the time horizon applied to theories of harm.
- (d) **Lower the bar for merger specificity:** It should be sufficient that claimed efficiencies will be achieved as a result of the merger, taking due account of the parties' evidence on the inferiority of contracts and partnerships to replicate the greater certainty of mergers, rather than requiring proof that no less anticompetitive alternatives exist.
- (e) **Recalibrate the approach to dynamic efficiencies:** For innovation-driven markets, the CMA should adopt a wider definition of efficiencies, expand the relevant time horizon, and accept greater uncertainty given the non-linear nature of innovation.

2. **THEME 1(a): THE CMA'S FRAMEWORK FOR ASSESSING EFFICIENCIES**

- (1) **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.**

- 2.1 Generally, the CMA's framework is appropriate. As elaborated below, we recommend changes to the way that the CMA interprets and applies each of these limbs.
- 2.2 As a more general point, we consider that REEs should be considered as part of, rather than as a subsequent step to, the assessment of a merger's effect on competition. If a merger results in efficiencies that make the combined entity a stronger competitor, any competitive analysis ignoring this aspect of a merger is not actually capable of testing whether the merger results in an SLC on the balance of probabilities.
- 2.3 It is artificial to assess certain effects of a merger on the combined entity's pricing incentives to a balance of probabilities standard (e.g. the effect of greater market concentration), but certain other effects on a standard implying a much higher degree of certainty (e.g. REEs).

- (2) **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:**

- (i) **What factors should the CMA consider when assessing the appropriate timeframe for efficiencies to be considered 'timely'?**

- 2.4 The appropriate timeframe fundamentally varies based on the nature of the efficiencies being claimed. For example:

- Efficiencies resulting from variable cost reductions or elimination of double marginalisation would usually have a shorter expected timeframe to realisation, most likely in the first year or two following integration.
- Efficiencies relating to R&D output would more appropriately be assessed over a longer time horizon.

2.5 The CMA's approach to assessing timeliness of REEs should be at least as long as the time horizon that the CMA applies when considering theories of harm; the further into the future the CMA is willing to look when considering possible adverse effects on effective pricing incentives (e.g. beyond the duration of existing contracts protecting consumers from price increases or downstream rivals from foreclosure), the further the CMA must similarly look to understand how REEs may impact pricing incentives.

(ii) 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?

2.6 The questions of sufficiency and likelihood are linked. As the standard for assessing the impact of a proposed merger on competition is the balance of probabilities, any factor capable of influencing that outcome should similarly be assessed on the balance of probabilities.

2.7 The degree of uncertainty allowed for by the CMA when assessing a theory of harm should be mirrored in the CMA's approach to assessing REEs. For example, the CMA should require less certainty around the likelihood of REEs when considering the net effect on an inherently more speculative theory of harm (say, one based on potentially overlapping R&D efforts that have not yet resulted in a marketable product that can be linked to a well-defined antitrust market) than when considering a theory of harm for which the CMA can have a greater degree of certainty (say, one based on increased concentration in existing well-defined markets).

2.8 The CMA should take into consideration, and parties to mergers should provide, expert evidence, including from finance professionals, and those who have modelled synergies on their expectations on the timeframe and nature of benefits that accrue (e.g. investment bankers). The CMA's assessment of sufficiency in balancing competitive benefits and harms should be evidence-led.

2.9 The legal concept of RCBs permits taking account of benefits that accrue to wider groups beyond those allegedly harmed by a merger. On this basis, the CMA is used to taking a view in the round, taking account of the evidence, and should do the same in its assessment of REEs.

(iii) 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?

- 2.10 The CMA’s approach sets a disproportionately high bar in requiring that there must be no less anticompetitive alternatives to the merger that could achieve the efficiencies in question. For example, the CMA considered at Phase 2 in *JD Sports / Footasylum*² that the claimed efficiencies were not merger-specific on the basis that they could have been achieved through alternative commercial arrangements between the parties (such as outsourcing or arms-length trading arrangements), notwithstanding that the claimed efficiencies themselves were timely and likely to occur. It should be sufficient that the claimed efficiencies will be achieved as a result of the merger.
- 2.11 The CMA should also give due regard to the different incentives involved in a merger as compared with a commercial agreement or joint venture. Mergers align parties’ incentives in a way that most commercial agreements cannot and inherently provide more structural certainty than contracts can.³ By analogy, the CMA has found in the airline industry (where transatlantic mergers are not possible due to foreign ownership rules) that only deeply integrated contracts with revenue sharing provide the most significant efficiencies.⁴
- 2.12 As the past is generally the basis for predicting the future when it comes to market shares, the same should apply to other aspects of the merging parties’ business. In theory, companies can pursue any imaginable course of action in a hypothetical counterfactual. However, companies may pursue mergers exactly to overcome uncertainty around the timeliness and likelihood of success of such alternative actions. The CMA should therefore apply a high evidentiary bar for arguments that the merger parties would undergo some counterfactual transformation. Importantly, internal documents projecting counterfactual future greatness should be assessed with the same degree of scepticism as deal documents predicting REEs; the world is littered with projects that never got off the ground.⁵
- (iv) 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?**
- 2.13 The likelihood of a merged entity passing through benefits to customers (and the immediacy / time horizon for that pass-through) is dependent on the level of competitiveness in the subject markets. This is recognised in the current Merger Assessment Guidelines.⁶
- 2.14 As the CMA explains, competition is “*a process of rivalry between firms seeking to win customers’ business over time by offering them a better deal. Rivalry creates incentives for firms to cut price, increase output, improve quality, enhance efficiency, or introduce*

² CMA, *Completed merger between JD Sports Fashion plc and Footasylum plc* (2020).

³ Grossman, S., Hart, O. (1986), *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*. *Journal of Political Economy*, 1986, vol. 94, no. 4

⁴ See the CMA’s investigation of the Atlantic Joint Business Agreement.

⁵ Bradley, C., Hirt, M., & Smit, S. (2018), *Strategy beyond the hockey stick: People, probabilities, and big moves to beat the odds*. Wiley. Chapter 3: Hockey stick dreams, hairy back realities.

⁶ CMA, *Merger Assessment Guidelines* (2021), para 8.20.

new and better products".⁷ Accordingly, the combined entity may pass through REEs along one or several of these dimensions, as discussed below.

Lower prices

- 2.15 It is generally accepted that reductions to marginal costs translate into incentives to set lower prices. Specifically, "*According to economic theory undertakings maximise their profits by selling units of output until marginal revenue equals marginal cost. Marginal revenue is the change in total revenue resulting from selling an additional unit of output and marginal cost is the change in total cost resulting from producing that additional unit of output*".⁸ Accordingly, "*lower input costs provide an incentive to compete more aggressively on price*".⁹ REEs that reduce marginal costs therefore create incentives to cut prices and thereby pass through these benefits to customers.
- 2.16 As the CMA explains, "*Where firms have significant spare capacity, they may be better able to compete. Conversely, firms facing capacity constraints may not be able to serve customers switching away from rivals and may provide a less effective constraint*".¹⁰ Any REE that directly alleviates capacity constraints or creates the incentives to undertake the investments should therefore presumptively translate into stronger competition and thereby lower prices even if direct costs of supply per unit do not change.

New and greater quality products

- 2.17 All else equal, improvements in quality are equivalent to lower effective prices. Mergers may facilitate quality improvements by giving the merging parties access to their shared pool of IP, knowhow, and best practices or by providing scale justifying greater R&D spend as any returns can be earned over a greater volume (see further discussion of R&D below). Whereas possible favourable changes in supply cost structure or capacity investments stimulating outright price reductions as discussed above may be readily measurable, incentives to improve quality may be more difficult to assess. However, the more differentiated the offerings of the merging parties are, the more likely it would seem to be that the merging parties have complementary and relevant, yet not already overlapping, skills that may translate into quality improvement.

Increased output

- 2.18 As competition is "*a process of rivalry between firms seeking to win customers' business over time by offering them a better deal*", expected increased customer take-up of the merged entity's services is a *prima facie* indicator that the combined entity would compete harder than as standalone entities. This is therefore arguably the most important indicator of pass-through of REEs. Whereas increased outputs may arise based on the incentives to lower prices or a greater ability to enhance quality, volume

⁷ CMA, *Merger Assessment Guidelines*, 18 March 2021 (CMA 129), ¶2.2.

⁸ European Commission, *Guidelines on the application of Article 81(3) of the Treaty* (2004/C 101/08), ¶98.

⁹ Case M.9730, *FCA/PSA*, economic annex, ¶103.

¹⁰ CMA, *Merger Assessment Guidelines*, 18 March 2021 (CMA 129), ¶4.12(c).

increases may also come about from, say, access to better distribution or a broader customer base. Transactions that enable the acquirer to add features to existing products or otherwise enable rapid scale of distribution for an incremental service therefore likely imply the pass-through of REEs to customers.

Enhanced efficiency

- 2.19 Improvements related to reductions in marginal costs or investment incentives are addressed under the discussion of pass-through in the form of lower prices. For other types of efficiency improvements, it can be difficult to establish pass-through to customers. However, the only way for competitive rivalry to promote such other types of efficiency improvements (as the CMA recognises that it does) is that suppliers pass these through in some way (otherwise the efficiency improvements would not be caused by competitive rivalry but by an unrelated profit incentive). Sufficiently effective competition thereby implies a presumption that even such efficiency gains to some degree will make their way to customers. The CMA should therefore be cautious about dismissing the relevance of material efficiencies even when the transmission link into lower prices or improved quality is not obvious.

Further dimensions the CMA should consider

- 2.20 In addition to the dimensions identified above, the CMA should also take into account wider benefits to society which may occur as a result of a merger, and which affect a broader range of consumers than just those which participate in subject markets. These considerations could include (i) whether the merger could positively assist in the UK's transition towards net zero, and (ii) the societal benefits that may be obtained through advanced innovation resulting from the combined technical know-how and R&D capabilities of the merging firms.

(3) 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)?

- 2.21 Economic evidence suggests that mergers combining firms active in vertically related markets are more likely to give rise to efficiencies than horizontal mergers. Vertical mergers are by their nature more likely to result in material REEs such as the elimination of double marginalisation.
- 2.22 However, any merger that results in (i) a reduction of the marginal costs of production for at least one entity (whether through elimination of double marginalisation, access to superior production technology, access to best in class sourcing of inputs, or access to lower cost distribution), and/or (ii) improved incentives to invest in capacity, are likely to create REEs. Such benefits may arise from both horizontal as well as vertical mergers.

2.23 It is generally accepted that organic market entry is subject to such material uncertainty as to not represent a relevant factor for the assessment of the existing market structure.¹¹ For the same reason, market entry through acquisition is likely a material source of efficiencies. Importantly, mergers generally take place at material premia to pre-merger valuations, including for take-private transactions where there are no commercial overlaps between the merging parties.¹² This supports that the acquiring party expects to materially transform the target company and thereby the way it competes. This supports that the relevant efficiencies are likely rivalry-enhancing.

(4) Are there circumstances in which efficiencies arising from a merger could create competition concerns, and/or circumstances where such concerns are unlikely to arise?

2.24 Competition is by its nature based on the premise that rivals push the frontier of product and price performance so as to attract customers at each other's expense. Mergers can be a way for suppliers to catch up with that performance frontier (and thereby improve competition) or a way to push that frontier (and thereby be an expression of the benefit of competition). As competition presumptively motivates laggards behind the product performance frontier to catch up with the leaders defining the product performance frontier, mergers pushing that frontier are presumptively beneficial.

2.25 Merger efficiencies may hypothetically result in diminished competition by moving the product performance frontier so far ahead of the value proposition of existing competitors that these competitors lose the ability to compete (market tipping). Such theories of harm should be approached with caution though. Whereas catching up with the new product performance frontier may be costly, difficult, and/or require mergers to acquire complementary capabilities, the prospect of counterfactual exit should provide a strong incentive for suppliers at risk of falling behind to pursue such actions.

2.26 In summary, as competition presumptively brings out the best in competitors, the baseline assumption should be that this is exactly what will happen in response to merger efficiencies. It is somewhat contradictory to hypothesise that a merger undermines competition by imposing on competitors the requirement to up their game to meet the stronger competition from the merged entity.

3. THEME 1(b): THE EVIDENCE BASE

(1) 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?

3.1 The CMA should consider the following evidence when assessing potential rivalry-enhancing efficiencies:

¹¹ Commission Notice on the definition of relevant market for the purposes of Union competition law (C/2024/1645), ¶23(c).

¹² Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings*, 7th Edition, page 321, Table 8.3.

- (a) **Market-specific expert evidence:** The nature and extent of any potential rivalry enhancing efficiency that is purported to arise from a merger is obviously dependent on the specific nature and structure of the subject market / industry. For example, a merger in a pharmaceutical context is more likely to give rise to potential efficiencies (which may be more geared towards R&D or product pipeline efficiencies) that would fundamentally differ from potential efficiencies arising from a merger in an industrial context (which may be more geared towards supply chain rationalisation / elimination of marginalisation). Expert, market-specific evidence should therefore be obtained to appropriately understand the structure of subject markets and frame an efficiencies analysis in this context.
 - (b) **Finance professional evidence regarding price efficiencies:** The extent to which a merger may create price efficiencies through, for example, reducing cost bases or marginalisation, is fundamentally an accounting and finance analysis which is best suited to be undertaken by finance professionals (including accountants). Accordingly, the CMA should seek and rely on robust evidence from finance professionals. Investment banks model the deal synergies on other significant deals, and those calculations should also be a source of evidence on which the CMA should seek to rely.
 - (c) **Internal documents on post-merger business plans:** The internal documents of the merger parties that set out post-merger business plans and synergies assessments are a helpful tool to contextualise the assessment and provide an indication of how the parties are thinking about a merger. However, these documents should be approached with a measure of caution, as explained in paragraph 3.6 below.
 - (d) **Evidence regarding incentives:** As the CMA explained in its call for inputs, *“Rivalry-enhancing efficiencies change the incentives of merging firms and induce them to act as stronger competitors to their rivals”* (¶3, emphasis added). If the parties can demonstrate that the proposed merger creates such helpful incentives, the CMA should assume that the combined entity will act on these incentives the same way as the CMA relies on the assumption that the combined entity would act in accordance with any changes to its incentives emanating from changes to the market structure produced by the proposed transaction. Whereas this assessment inherently is an economic one based on an understanding of the relevant market(s) and the cost structure of the merging parties, any economic theory benefits from being tested for consistency against the documentary evidence of the parties.
- (2) **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?**

3.2 Any assessment undertaken by the CMA should be based on the best available evidence which may be both qualitative and quantitative.

- 3.3 The analyses of efficiencies should rely on quantitative evidence as far as possible, however in certain markets – or for certain kinds of efficiency claims (e.g. non-price related efficiencies) – quantitative evidence may be less available or less useful. Consequently, an analysis may invariably involve qualitative aspects.
- 3.4 For example, whereas it may be straightforward in certain contexts to establish quantitatively that a merger will likely release capacity constraints through improved investment incentives, it will unlikely be possible to forecast the exact resulting expansion.
- 3.5 Fundamentally, it is not meaningful to assess the competitive effects of a merger resulting in rivalry enhancing efficiencies without taking these efficiencies into account directly in the competitive assessment. The relevant approach is therefore not one of comparing positive and negative effects on competition but rather an exercise in modelling the net effect directly.

(3) 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?

- 3.6 Merging parties will hold internal documents as to post-merger business plans; financial and operating information including as to costs; evidence on R&D processes and budgets. Additionally, the merging parties should be well placed to provide (i) cost accounting evidence for any assessments of how the merger may affect incremental costs of production and expansion, (ii) evidence on how the companies make investment decisions/allocate capital during their normal course of business, and (iii) sales forecasts. Note, however, that pre-merger planning often does not always involve a detailed efficiencies analysis upfront and is often more high level, with the transaction rationale being driven by fundamental conviction in overall direction of travel or business necessity rather than granular, bottom-up assessments of efficiencies. Modelling of efficiencies typically (i) comes quite late in the process as preparation for integration rather than as part of the merger rationale, and (ii) focuses on categories of operating costs rather than the kind of marginal cost/marginal investment type of analyses relevant for the regulatory assessment.
- 3.7 Merger parties are less likely to hold helpful evidence regarding the extent of any pass-through of efficiencies to end consumers. Such evidence / assessment is challenging to obtain because this is not typically modelled by merging parties in the ordinary course of planning for a merger.
- 3.8 Other evidence which the merging parties may hold internally, but which are gathered from third-party sources, are historic or contemporaneous industry comparators; expert evidence; innovation cycles and investments.

4. THEME 1(c): DYNAMIC EFFICIENCIES AND INNOVATION

- 4.1 For a merger involving two entities active in dynamic markets where competition is more speculative and constantly evolving, the CMA's efficiencies analysis must necessarily adapt appropriately to account for more dynamic efficiencies.

- 4.2 Historically, parties have had a particularly difficult time succeeding on efficiencies arguments for dynamic markets. This is evident in the CMA’s assessment *Illumina / Pacific Biosciences*¹³, where efficiencies arguments were rejected in full on the back of the CMA’s high bar for concrete supporting evidence.
- 4.3 The outcome of R&D efforts is not always easy to predict – innovation can be non-linear. A consideration of REEs should therefore not demand that parties provide evidence that R&D/innovation efficiencies will lead to returns but rather put more weight on the opportunity/ability for R&D efforts to be realised because of the potentially significant upsides. Adoption of this approach is key to unlocking growth in the UK.
- (1) 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?**
- 4.4 The ability and / or incentive for a combined firm to undertake R&D and innovate can be positively impacted in the following ways:
- (a) The combination may eliminate duplicative R&D efforts. This is an efficiency even if the CMA may consider that overlapping R&D pipelines could reduce the combined entity’s incentive to innovate.
 - (b) The combination may aggregate expertise and resources, and facilitate the sharing of ideas / technical know-how / IP (in a way that cannot be achieved absent the merger).
 - (c) Increased scale resulting from a combination can further enable a firm to take more speculative risks relating to R&D and innovation efforts. Whereas making material investments in a single project with a low probability of success is a gamble, undertaking a high number of such projects is a business model (much the same way as visitors to a casino are gamblers but the casinos accepting their bets are businesses). However, implementing such a business model requires scale enabling the pursuit of many such projects in parallel and allowing the firm to absorb temporary volatility in outcomes.
- 4.5 Mergers are likely to increase a firm’s risk mitigation and risk absorption capabilities, which may be material sources of merger efficiencies in R&D driven industries. This is because avoiding duplication of efforts in related fields not only reduces the cost of pursuing a given market opportunity (and thereby improves expected returns) but also frees up resources to pursue unrelated opportunities that provide the uncorrelated outcomes needed to mitigate risks across the portfolio of projects.
- (2) What evidence should the CMA consider when assessing whether a merger will likely increase R&D and/or innovation in the relevant products/markets?**

¹³ CMA, *Anticipated acquisition by Illumina, Inc. of Pacific Biosciences of California, Inc.* (2019).

- 4.6 The CMA should consider the following evidence when assessing the likely impacts of a merger on R&D / innovation:
- (a) Internal documents on pipeline and R&D strategy.
 - (b) Projected changes in R&D spending.
 - (c) Comparisons with historic mergers in the same or similar markets.
- 4.7 A merger that reduces the overall cost (through avoidance of duplication) and risk (by enabling a broader portfolio of projects) of pursuing risky R&D improves the incentives for the combined entity to undertake R&D. The combined entity should be presumed to act on such incentives.
- 4.8 The greater the innovative capabilities of the combined entity's rivals, the greater the CMA's comfort should be that the combined entity will act on its enhanced incentives. Also, the shorter the relevant product cycles, the quicker any benefits from improved R&D will materialise and the greater the exposure to reduction in demand associated with falling behind rivals. The duration of innovation of product cycles may therefore also be relevant for the CMA's assessment.
- (3) Are there circumstances in which mergers can foster innovation more broadly across a market or sector? Please provide evidence to support your answer.**
- 4.9 Mergers may foster innovation more broadly across a market or sector particularly (i) in markets characterised by dynamic competition where the increased rivalry from the enhanced efforts of the merging firm incentivise other firms to ramp up efforts to guard against loss of sales to the merged firm; or (ii) where innovation breeds further innovation as it unlocks new technologies and approaches.
- 4.10 Mergers may act as exit mechanisms for innovators whose ability to attract capital in the first place may be premised on the possibility of such liquidity events. The recognition that mergers are a natural way for companies to rapidly gain new capabilities and for innovators to monetise their core value-add may therefore contribute to the overall ecosystem of innovation.
- (4) To what extent, and how, should the CMA's approach differ between assessing static and dynamic efficiencies (e.g. with respect to the framework set out in paragraph 11 above)?**
- 4.11 Consideration of dynamic efficiencies requires the following:
- A different approach to what the CMA means by "timely". The time horizon must be expanded given efficiencies in dynamic markets may evolve over a much longer period rather than being immediately tangible. This depends on the market in question and the length of typical R&D cycles.
 - A different approach to what the CMA considers to be sufficiently certain. This includes taking a symmetric approach to dynamic harms and dynamic efficiencies. The mere potential to unlock better R&D efforts should be considered an

efficiency even if the outcomes are not certain, as the upside could be large. Innovation can be non-linear and unpredictable.

- A wider definition of efficiencies. The CMA tends to focus more on short-run price changes, but efficiencies claims may involve non-price competition and innovation.

(5) What are the challenges with assessing dynamic efficiencies as compared to static efficiencies? How can these challenges be overcome in practice?

- 4.12 The key challenges in assessing dynamic efficiencies are the inherent uncertainties surrounding (i) dynamic effects, (ii) realisation of R&D efficiencies, (iii) measurability, and (iv) verifiability.
- 4.13 By definition, it is not possible to overcome these challenges by simply adducing better evidence. The only way to overcome these challenges is for the CMA to be willing to adjust the lens through which it analyses dynamic efficiencies – being more open to non-price efficiencies or those that cannot be concretely quantified or predicted. This will unlock more opportunities for growth and innovation in the UK.
- 4.14 As noted above, the CMA must accept as its baseline assumption that the merging parties will act on improved incentives. Importantly, mergers may be the expression of dynamic efficiencies by enabling scale and cost reductions that competition according to economic orthodoxy promotes.

5. THEME 2: THE CMA'S EFFICIENCIES PROCESS

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

- 5.1 Currently, the general experience of merging parties is that when REE claims are put forward, they have rarely influenced outcomes. This has the effect of discouraging merging parties from submitting evidence and explanations regarding REE claims because there is a general impression that they are not seriously considered and/or that they involve a concession on the existence of an SLC.
- 5.2 The CMA should facilitate merging parties to raise REE-based arguments at Phase 1 and Phase 2, in a way that does not put the merging parties in a position where they are effectively conceding an SLC by doing so. As discussed above, consideration of REEs should be incorporated as an essential part of the SLC assessment. If a merger generates REEs that more than offset the impact of greater market concentration, then there is no SLC in the first place.
- 5.3 This could be achieved through structured opportunities for dialogue on efficiencies at pre-notification, Phase 1 and Phase 2, including dedicated meetings or sections of existing meetings (state of play, issues meeting) focused on efficiency claims. The CMA could encourage technical meetings between economists and/or finance professionals at both Phase 1 and 2.

5.4 The CMA should further provide concrete and actionable feedback on parties' REE arguments, so that parties can understand the further evidence or methodological approaches that could support them.

(2) **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?**

5.5 Barriers that exist for parties to raise efficiency claims include:

- **Perception:** There is currently a widespread view among practitioners that efficiency arguments are rarely successful before the CMA, leading parties to deprioritise or abandon such claims from the outset. This is due to the perception that the CMA applies a higher evidentiary threshold to efficiency claims than to theories of harm, discouraging investment in developing such arguments.
- **“Efficiency offence” concern:** Apprehension that advancing efficiency claims may inadvertently signal market power or the ability to raise prices, potentially strengthening the case against the merger.
- **Timing and resource constraints:** Efficiency claims are onerous for parties to substantiate and may be at odds with the CMA's “pacey” approach to pre-notification and the compressed Phase 1 timeline.

5.6 Steps that the CMA could take to reduce or remove these barriers include:

- Issue updated, detailed guidance clarifying: (i) the types of rivalry-enhancing efficiencies most likely to be accepted; (ii) acceptable methodologies for quantification; and (iii) concrete examples of successful claims.
- Publish anonymised case studies or worked examples illustrating how parties have successfully substantiated efficiency arguments.
- As above, provide structured opportunities for early, informal engagement on efficiency claims before positions become fixed.

(3) **Are there any learnings which the CMA can take from how efficiencies are considered in other jurisdictions or by other regulatory bodies?**

5.7 Many jurisdictions (including notably the EC) take a similarly stringent approach to efficiencies in merger control. However, this is not to say that such an approach is proportionate and it is open to the CMA to forge a different path.

5.8 The CMA is relatively unusual in separating its consideration of efficiencies into REEs and RCBs, and it is notable that the CMA is only willing to consider out-of-market benefits in the latter (whereas REEs must arise in the markets where any SLC may occur).

5.9 Many jurisdictions diverge from this approach and consider out-of-market benefits as fundamental to the analysis of a merger. This notably includes Canada, Australia, New

Zealand and Norway, which adopt a “total welfare” approach which calculates the overall net effect on society of a merger and weighs this against the potential harms brought about by a mergers.

5.10 As discussed above, the CMA would benefit from adopting a broader analytical framework and incorporating consideration of out-of-market efficiencies in its REE assessment, so as to capture the true effect that a merger may have on the broader economy which is not presently realised in a competitive assessment.

(4) Are there any other ways in which the CMA’s approach to assessing rivalry enhancing efficiencies could be improved to embody the 4P principles of pace, predictability, proportionality and process?

5.11 See responses to 7(1)-(3) above.