Comments of
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on
Competition and Markets Authority Draft Revised Guidance on assessing merger efficiencies
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Merger efficiencies

1. This paragraph should explicitly state that efficiencies can prevent an SLC. That key point is not made until ¶ 4.

This paragraph should not make the unimportant point in the ultimate sentence. Rivals' reactions are far less important and far less predictable than the actions of the merged firm. Moreover, rivals' reactions are not what could enhance the process of dynamic competition; that is the merger.

What are merger efficiencies?

The CMA should more fully answer the question: What are merger efficiencies? The opening sentence of ¶ 1 defines "merger efficiencies" functionally, as anything causing mergers to enhance rivalry or otherwise benefit consumers. But the CMA also should address two specific questions, the answers to which are the CMA's most important policies on "merger efficiencies."

Does the CMA credit "merger efficiencies" without regard to whether the source is a "true efficiency," i.e., a real resource saving? Crediting "merger efficiencies" that are not true efficiencies encourages mergers that eliminate competition in purchasing, e.g., mergers that lower prices by depressing wages. Such mergers do not benefit consumers as a whole and should be found to produce an SLC. Crediting "merger efficiencies" that are not true efficiencies also encourages mergers that just shift costs. In the absence of real resource savings, input price reductions for the merged firm likely force price increases to others, including the merged firm's relevant-market rivals.

In determining whether a merger will lead to an SLC, does the CMA focus on the competitive process or its outcome? In most cases, there is no practical difference, but some "merger efficiencies" mentioned in ¶ 6 improve outcomes and yet do not appear to enhance rivalry. For example, eliminating double marginalization (EDM) entails a pricing decision unrelated to rivalry.

4(a). The idea of "offsetting any anticompetitive effects" is straightforward when efficiencies prevent a merger from producing any anticompetitive effects. In the unilateral effects context, cost reductions in excess of the Compensating Marginal Cost Reductions (CMCRs) prevent price increases. See References below. The idea of "offsetting anticompetitive effects" is not straightforward otherwise. The Merger Assessment Guidelines (MAGs) should articulate whatever principles the CMA applies when a merger would have harmful effects in one dimension of competition (e.g., price) but beneficial effects in a different dimension of competition (e.g., innovation). Quantitative weighing is infeasible.

4(b). In accounting for relevant customer benefits, the CMA goes beyond the relevant market, and the CMA should stress that it does so only in accounting for relevant consumer benefits, if that is the CMA's policy.

5. This paragraph should directly state that the scope of the CMA's SLC assessment is bounded by the relevant market, if that is the CMA's policy, although the point perhaps instead should be in ¶ 4(a).

The phrase "within any market or markets" in the Enterprise Act might be understood to permit assessment across multiple markets when competition encompasses multiple markets. Indeed, footnote 129 in the 2021 MAGs could be read to imply that the CMA read the Act that way five years ago.

Examples of situations where merger efficiencies can arise

6(a). The CMA should not refer to "economies of scale" in explaining "merger efficiencies." When a merger leads to "more efficient use of the combined capacity of the merger firms," that does not allow the merged firm to "take advantage of economies of scale." Mergers do not alter the scale of production facilities, so near-term cost savings cannot result from the realization of economies of scale.

6(b). The CMA should not stress "better terms from suppliers" because they can result from an SLC in a relevant input market. The CMA should stress longer production runs and larger shipments, both of which give rise to resource savings.

6(c). The CMA should mention the cost reductions that result from combining complementary facilities.

6(d). Combining "complementary products" can "create incentives for the merged firm to lower prices," but that effect rarely is significant in merger cases, and that effect entails a pricing decision rather than a true efficiency.

6(e). As noted above, EDM entails a pricing decision rather than a true efficiency. Further, EDM should not be treated as an efficiency when the CMA is assessing theories of foreclosure or raising rivals' costs. In that context, the upstream and downstream margins are critical facts in assessing the theory of harm, and the CMA is responsible for developing facts supporting its theory of harm.

How the CMA assesses evidence of merger efficiencies

7. The CMA should be more precise by referring to "sources of benefits resulting from a merger" rather than to the benefits themselves. The essential starting point for an efficiencies assessment is a verifiable statement of how a merger produces benefits. A mere list of benefits alleged to flow from a merger is useless without a cogent articulation of their precise sources.

In footnote 2, the CMA should not say that it attaches "more evidentiary weight to such documents if they were generated prior to the period in which the merger firms were contemplating or aware of the merger." Evidence on merger-specific efficiencies cannot be generated before a specific merger is contemplated.

7(a). The CMA should say something about the relevance of the data mentioned because that is not obvious.

9. It would be helpful for the CMA to say something about what it expects to learn from these sources, perhaps just saying that it seeks to verify the merging firms' contentions.

10. The CMA should delete both this paragraph and footnote 3. No justification is needed for taking a case-by-case approach, and nothing in the empirical literature is useful in the CMA's work. Nor should the CMA doubt the potential of vertical mergers to generate efficiencies (especially in the broad sense that the CMA uses the term). Indeed, efficiencies from horizontal mergers generally stem from vertical aspects of the combinations. Horizontal mergers often bring together complementary resources and capabilities, although they cannot alter the scale of the merging firms' production facilities.

11. The CMA should revise the second sentence of this paragraph. The incentive to realize efficiencies rarely is in doubt, and mentioning the incentive to pass on benefits is problematic. Neither the Draft Revised Guidance (DRG) nor the MAGs set a predicate for consideration of pass-on. Moreover, the extent of pass-on by the merged firm typically is determined by the shape of the demand curve and the nature of the competitive process (see References), neither of which the merging firms can be held responsible for proving.

The Enterprise Act directs the CMA to determine whether a merger likely would result in a "substantial lessening of competition." Efficiencies obviously can be relevant to that determination, but pass-on is not obviously relevant because it concerns the outcome of the competitive process rather than the process itself. If the CMA understands the Enterprise Act to adopt a consumer welfare standard, that should be said in the first sentence of this section of the MAGs. The 2021 MAGs lean in that direction (see ¶¶ 1.2–1.4), but they stop short. If the CMA is focused on the process of competition but believes that pass-on nevertheless is relevant, its relevance should be explained in the opening paragraphs of this section.

The CMA's framework for assessing rivalry-enhancing efficiencies

14. As the heading makes clear, to be relevant to an SLC assessment, merger efficiencies "must enhance rivalry." But that is not what paragraph seems to say. It will be read to assert that merger efficiencies are "relevant" to an SLC assessment only when, as a consequence of the efficiencies, "there is no SLC."

16. The CMA should use short, simple statements in this paragraph. The opening sentence could be: "Reductions in variable costs normally result in lower prices." With the qualification "normally," the statement simply is true, rather than a "view" the CMA has taken. The second sentence could be: "Reductions in fixed costs normally do not affect prices but might make certain investments profitable." The qualification "normally" is needed here because pricing is not invariably an incremental decision.

The CMA should delete the ultimate sentence of the paragraph. Cost reductions from output reductions plainly are not efficiencies, so the CMA need not offer its judgment on the matter. Cost reductions from output reductions could be relevant under a total welfare standard, but nothing in the DRG or the 2021 MAGs suggests that the CMA applies a total welfare standard.

17. Mergers have the potential to enhance quality and innovation when they bring together complementary assets and thereby open up new possibilities. This phenomenon is not captured by the phrase "reduce the incremental cost of innovation," nor is that concept well defined in economics. The other two potential effects on innovation mentioned in the paragraph are part of the new possibilities.

18. The CMA should delete the opening sentence of this paragraph. Its point should be made in ¶ 4 or ¶ 5 and not be repeated here. The CMA should delete the final clause from the second sentence of the paragraph. The response of rivals does not result "in increased rivalry;" it is the result of increased rivalry.

19. The CMA should reconsider this paragraph. It announces that the CMA is prepared to determine that a merger gives rise to an SLC solely on the basis that it generates efficiencies. The CMA provides cold comfort in stating that it expects to pursue this possibility only rarely.

20–22. The CMA should try to give more specific guidance. In many cases, negative effects can occur more quickly than positive effects. The timing difference must be decisive at some point.

20. The points in this paragraph are well taken, but "rationalising distribution capabilities" can be quite difficult and thus cannot be done "relatively quickly."

24. The likelihood assessment is inherently difficult because there are severe limits to what the CMA can do. The CMA should determine what the merged firm likely can accomplish in a straightforward manner. When projected merger benefits relate to innovation, the CMA can evaluate the significance of complementarities but not what will come from them. The CMA should not stress previous mergers because they rarely present the same merger-specific efficiencies.

25. The CMA should revise this paragraph. It is not clear that the issue is "incentive." If the gains might not exceed the costs, that seems more a matter of likelihood than incentive.

26. Remedies can allow efficiencies to be realized while eliminating the CMA's concerns, but that is true primarily for efficiencies outside the relevant market. Here, the efficiencies would "enhance rivalry" in the relevant market. The CMA should not force a reader to locate and consult the guidance on merger remedies to discover that CMA has in mind remedies requiring investments rather than remedies requiring divestitures.

27–30. These paragraphs fail to relate the two most useful insights on sufficiency: (1) Marginal cost reductions exceeding the CMCRs are sufficient to prevent price increases from unilateral effects. See References. (2) When the CMA weighs incommensurate effects, large efficiencies are sufficient if anticompetitive effects are small, and reasonably certain efficiencies are sufficient if anticompetitive effects are merely possible.

27. The CMA should delete the ultimate sentence of this paragraph. A merger has no predictable impact "on incentives to pass on benefits." There is substantial pass-on following even a merger to monopoly, although efficiencies almost certainly are insufficient.

29. The CMA should delete or relocate this paragraph because nothing in it seems relevant to sufficiency.

31–33. The CMA should revise these paragraphs. The proper inquiry identifies the but-for world—what the merging firms would do if they could not merge (see MAGs ¶¶ 3.1–3.9). These paragraphs speculate about what the merging firms might be able to do, but the fact that they have not already done those things is strong evidence that they would not do them absent the merger.

32. The CMA should not consider the possibility of "achieving scale or developing capabilities organically." If possible at all, that alternative is slow and loses the race. The CMA should not speculate that joint ventures can achieve the efficiencies of mergers because rivals cannot be expected to cooperate. The CMA should not speculate that contracts can solve double marginalization problems because that might not be possible even in theory and the fact that it has not been done is telling evidence. The CMA should not refer to "non-merger expansion along the supply chain" because no one will understand what that means.

34. The CMA should delete or elaborate this paragraph. Passing-on is not usually conceived as a matter of incentive, and the CMA's consideration of incentives is unclear. The ultimate sentence refers to "the strength of competition," but the strength of competition is not what determines pass on. See References. Furthermore, the CMA should indicate why it cares about pass-on.

The CMA's framework for assessing rivalry-enhancing efficiencies

35–39. Section 30 of the Enterprise Act defines customer benefits as "lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom." These paragraphs suggest that the CMA believes that everything benefiting society can count as customer benefits. If that were so, the CMA could cease to be an advocate for competition and become an agency of industrial policy.

Engaging with the CMA on merger efficiencies

40. The CMA is right to encourage early engagement, and the CMA should require explanation and documentation from the merging firms, but the CMA should proactively try to verify the parties' claims. The CMA should be skeptical, but it should not reject efficiency claims without close scrutiny. Doubtful claims can prove legitimate and substantial.

41. The CMA is right to instruct merging firms to "provide a detailed explanation of how the merger would generate" efficiencies, but "reference to the framework in paragraph 13" is not what is needed. How the merger would generate efficiencies is the essential starting point for the assessment. Once the "how" is clarified and verified, the CMA can apply the criteria in ¶ 13.

Qualifications

These comments reflect 42 years of merger enforcement in the Antitrust Division of the U.S. Department of Justice, plus experience producing the 1982 and 1984 Merger Guidelines, the 1997 revision of the efficiencies section of the 1992 Horizontal Merger Guidelines, the 2006 Commentary on the Horizontal Merger Guidelines, the 2010 Horizontal Merger Guidelines, and the 2020 Vertical Merger Guidelines. The comments also reflect the insights gained by authoring more than 60 articles and book chapters on merger assessment and merger guidelines.

References

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