Merger efficiencies review – response to the CMA's draft revised guidance

A submission by Frontier Economics

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1 Frontier Economics is an economic consultancy that regularly advises clients on both national and European merger investigations, including a significant number of cases before the UK Competition and Markets Authority (**CMA**).

2 We welcome the opportunity to provide views on the CMA's draft revised guidance on merger efficiencies. As set out in our response to the CMA's initial call for evidence, we believe that efficiencies are an important channel through which mergers can generate benefits for UK consumers, businesses and the wider economy.

3 In our view, the CMA's draft revised guidance represents a positive step towards ensuring that merger efficiencies are assessed as an integral part of the CMA's competitive assessment, in a balanced and evidence-led manner. The extent to which it delivers benefits for UK consumers and businesses will ultimately depend on whether those principles are reflected consistently in the CMA's day-to-day casework.

4 Our response below highlights both the progress reflected in the draft revised guidance and a small number of areas where further refinement would strengthen the final guidance. In particular, we consider that:

(a) the shift in both the tone and substance of the guidance represents a clear change in the CMA's approach to merger efficiencies;

(b) a small number of targeted refinements would improve clarity and predictability for merging parties and CMA case teams; and

(c) the benefits of the revised guidance will depend on its consistent implementation in practice.

1 A clear, positive and meaningful shift in tone

5 The draft revised guidance represents a significant improvement on the existing guidance by providing greater clarity to merging parties on both the circumstances in

which merger efficiencies may arise and the evidence that the CMA will consider in evaluating them. In particular:

(a) We welcome the broader discussion of the circumstances in which efficiencies may arise, including the explicit recognition of dynamic efficiencies,[1] which were not addressed in the previous guidance.

(b) We also welcome the additional guidance on the types of evidence that the CMA consider, including the recognition that bespoke economic analysis may be valuable where internal documents alone cannot adequately address the CMA's analytical framework.[2]

(c) We welcome the additional text suggesting that the CMA will adopt a "consistent" approach to assessing evidence on competitive harms and evidence on benefits.[3] This should help promote a more balanced assessment of evidence relating to competitive harms and merger efficiencies.

6 Although some of the textual changes may appear subtle in isolation, they represent important changes in how the CMA describes its approach to merger efficiencies. Collectively, these changes should support a more substantive assessment of efficiencies in practice.

(a) The previous guidance noted that it was *"rare"* for a merger to be cleared on the basis of relevant customer benefits.[4] The draft revised guidance has removed this text and instead noted that the same analytical principles – including merger specificity, likelihood and timeliness – apply when assessing rivalry-enhancing efficiencies (**REEs**) and relevant customer benefits (**RCBs**).[5]

(b) In relation to the "timely" criteria, the previous guidance noted that *"the longer the time period necessary for efficiencies to be realised, the greater will be the level doubt that efficiencies will be realised at all".*[6] The draft revised guidance has removed this text and noted that the CMA is open to considering efficiencies which are likely to arise on a longer timeframe, while recognising that future gains should be appropriately discounted.[7]

1 CMA's draft revised guidance on merger efficiencies, paragraph 6.

2 CMA's draft revised guidance on merger efficiencies, paragraphs 7 and 8.

3 CMA's draft revised guidance on merger efficiencies, paragraphs 12.

4 CMA's MAGs , paragraph 8.27.

5 CMA's draft revised guidance on merger efficiencies, paragraph 39.

6 CMA's MAGs , paragraph 8.12.

7 CMA's draft revised guidance on merger efficiencies, paragraph 20.

(c) The draft revised guidance also recognises that, where the CMA's concerns relate to the likelihood that efficiencies will be realised, remedies may be capable of securing those efficiencies.[8] This reflects a more pragmatic approach to addressing uncertainty than was evident in the previous guidance.

7 Taken together, these changes signal a genuine shift in the CMA's approach merger efficiencies. The key test will now be whether those principles are reflected consistently in the CMA's assessment of mergers in practice.

2 Targeted refinements to strengthen the final guidance

8 The CMA's revisions suggest that it has engaged constructively with stakeholder feedback and incorporated a number of sensible changes. We particularly welcome:

(a) the acceptance of several important conceptual and analytical changes suggested by respondents, including a broader view of the types of efficiencies that may be relevant and a more balanced approach to their assessment; and

(b) the emphasis on economic and expert input, including from industry experts and sector regulators, in assessing issues such as the quantification of efficiencies and the ability and incentive of merging parties to realise them. This should help reinforce that the CMA's assessment will remain evidence-led.

9 We nevertheless consider that the final guidance could go further in three respects:

(a) It would be helpful to explain more clearly what the CMA means by "likely", including the practical threshold it will apply in assessing whether efficiencies are likely to be realised (for example, 50% probability at Phase 2). Setting this out clearly would provide greater predictability for merging parties and case teams alike.

(b) The guidance could provide further detail on the analytical frameworks or techniques that it would consider helpful in quantifying RCBs, including sustainability benefits. This would provide greater certainty to merging parties when preparing evidence and promote a more consistent approach across CMA case teams.

(c) The CMA should also draw out more explicitly the lessons from past cases that provide useful examples of how aspects of the revised approach can work in practice. Several of the changes reflected in the draft revised guidance codify

8 CMA's draft revised guidance on merger efficiencies, paragraph 25.

practices that the CMA implemented in *Vodafone / Three*.[9] No single case will capture the full range of merger situations that the CMA will encounter. Even so, a short worked example or case reference would give merging parties a clearer sense of how the CMA expects the revised guidance to operate in practice.

3 Implementation will determine the impact of the revised guidance

10 The revised guidance will deliver tangible benefits for consumers and businesses only if it leads to a more meaningful assessment of efficiencies in the CMA's day-to-day casework.

11 In our view, a good outcome would be one in which:

(a) merging parties engage early and provide the CMA with the relevant evidence on efficiencies;

(b) the CMA tests that evidence, using its own expertise and, where helpful, inputs from external experts, sector regulators and third parties; and

(c) efficiency claims are assessed in a balanced way alongside evidence of potential harm.

12 Based on our experience of merger casework, three practical risks could make that outcome harder to achieve if they are not managed carefully.

(a) Merging parties may submit speculative or excessively lengthy submissions on efficiencies, including in cases where efficiencies are unlikely to be material to the CMA's assessment.

(b) The CMA may, in applying the guidance, continue to exercise its discretion in a way that sets an unduly demanding evidential threshold for efficiencies, limiting the practical impact of the revised guidance.

(c) A perception that efficiency claims are unlikely to succeed, or may be interpreted as implicitly accepting a substantial lessening of competition (**SLC**), may continue to discourage merging parties from investing in the evidence and analysis needed to substantiate well-founded efficiencies claims.

9 For instance, the discussion on the use of remedies to secure the likelihood (at paragraph 26 of the draft revised guidance) and sufficiency (at paragraph 30) of efficiencies through remedies is similar to the approach adopted by the CMA in *Vodafone / Three*.

13 Addressing these challenges will require continued engagement across the UK competition community. Merging parties, their advisers and the CMA each have a role to play in ensuring that the revised guidance is translated into a more effective and evidence-led assessment of merger efficiencies in practice.

14 Merging parties and their advisors should lead with the strongest evidence available, supplement it where necessary with robust economic analysis, and avoid speculative or unevidenced claims. For instance:

(a) Where internal documents and data are directly responsive to the CMA's criteria for evaluating efficiencies, merging parties should lead with that evidence and present it in a manner that clearly maps onto the CMA's criteria. This would assist the CMA's assessment as it is able to place – as per the draft revised guidance – greater weight on evidence prepared before the merger was contemplated.

(b) Where the available evidence from internal documents and data is incomplete or not directly responsive to the CMA's criteria on merger efficiencies, merging parties should develop robust economic analysis that helps the CMA's decision making.

(c) Where the available evidence is unsupportive of an efficiencies case, merging parties and their advisors should refrain from making speculative and/or unevidenced claims to the CMA.

15 The CMA should aim to apply a balanced approach in judging evidence and share learnings from its casework with the wider competition community. In particular:

(a) The assessment of efficiencies is forward-looking, and the draft revised guidance recognises the uncertainty that is inherent in forecasting. The CMA should apply the guidance in a balanced way and should not be unduly cautious where the evidence is robust.

(b) Internal documents can be informative, but they often have limited value for assessing and fully substantiating efficiencies where each party has only partial visibility of the other's capabilities before a transaction is signed. The CMA should therefore distinguish between cases where external evidence is available to test the economic modelling and cases where it is not, in which case the economic evidence should be assessed on its own merits.

(c) By publishing more detail on efficiency assessments in its casework, whether through decisions on supplementary guidance, the CMA can help build a clearer body of practical guidance for future cases.

16 Overall, we welcome the draft revised guidance and the direction of travel it represents. It is a positive and meaningful step towards a merger control regime that

remains rigorous while giving appropriate weight to efficiencies that benefit UK consumers, businesses and the wider economy. In practice, however, the benefits will depend on how consistently the revised guidance is applied in day-to-day casework. We welcome the CMA's collaborative approach to this review and look forward to continuing to engage as the revised guidance is implemented and its practical application develops.