

## 1 Introduction

- 1.1 The Merger Assessment Guidelines (“**MAGs**”) recognise that rivalry-enhancing efficiencies should be considered when assessing mergers.<sup>1</sup> Where efficiencies strengthen the merged firm’s incentives to compete, they can outweigh any potential reduction in competition that might otherwise arise from the transaction.<sup>2</sup> Appropriate assessment of these efficiencies is therefore central for the CMA’s duty to promote competition and protect consumers and in turn directly related to its end goal of driving economic growth and improving household prosperity.<sup>3</sup>
- 1.2 However, to date the CMA has never unconditionally cleared a merger on the basis that rivalry-enhancing efficiencies (“**efficiencies**”)<sup>4</sup> were sufficiently strong to offset an identified competition concern.<sup>5</sup> Mergers and acquisitions are often pursued precisely because they can generate synergies and efficiencies. These expected benefits are often reflected in the premia paid above the pre-transaction market valuations. Even assuming that companies may overstate achievable efficiencies, it nevertheless seems unlikely that there are no cases in which rivalry-enhancing efficiencies were material enough to justify clearance.
- 1.3 We therefore welcome the CMA’s consultation on this issue and the opportunity to contribute with this submission.
- 1.4 In our response, we cover the following topics:
- (a) Efficiencies as part of the competitive assessment;
  - (b) Whether efficiencies are rivalry-enhancing;
  - (c) Timeliness;
  - (d) Likelihood;
  - (e) Sufficiency;
  - (f) Merger specificity;
  - (g) Whether efficiencies will benefit consumers.

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<sup>1</sup> MAGs, paragraphs 8.8 – 8.20.

<sup>2</sup> MAGs, paragraph 8.4.

<sup>3</sup> [CMA strategy 2026 to 2029](#), p. 2.

<sup>4</sup> The MAGs identify two categories of efficiencies: rivalry-enhancing efficiencies and relevant customer benefits (“**RCBs**”) (MAGs, paragraph 8.3). Unless explicitly stated otherwise, in this response we focus on rivalry-enhancing efficiencies.

<sup>5</sup> While the CMA has cleared mergers on the basis of RCBs (i.e., non-rivalry-enhancing efficiencies), these have been exclusively in NHS hospital mergers, and in any case are not the subject of this consultation.

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## 2 Efficiencies as part of the competitive assessment

- 2.1 The MAGs define rivalry-enhancing efficiencies as those which "*change the incentives of the merger firms, and induce them to act as stronger competitors to their rivals*".<sup>6</sup> As such, the assessment of these efficiencies should be an integral part of the competitive assessment, so that the CMA makes a complete evaluation of whether overall the merger will reduce competition (i.e., give rise to an SLC). Assessing such efficiencies requires understanding the incentives of the merger firms to compete, and whether the merger will change those incentives – the same questions that are at the core of the competitive assessment. The question should be, "will there be an SLC following the merger?", and as a matter of economics, answering that question requires forming a view about any efficiencies that arise and improve the merged firm's ability and incentive to compete.
- 2.2 This is not the current practice. The MAGs state that "*The CMA will generally first consider whether there is scope for an SLC and, if there is, it will consider rivalry enhancing efficiency claims from the merger firms*".<sup>7</sup> While the MAGs further state that "*the CMA may consider efficiencies and the evidence for an SLC together*",<sup>8</sup> in practice, this is rarely done. For example, and consistent with the MAGs, in cases such as Sabre / Farelogix, Thermo Fisher / Gatan, Illumina / PacBio and Microsoft / Activision the Parties appear to have submitted detailed efficiency claims, but the CMA discussed these as 'countervailing factors' in its decisions<sup>9</sup>, only after the conclusion that an SLC was likely to arise had been drawn.
- 2.3 The separation between the efficiencies assessment and the competitive assessment is also apparent from the evidence gathering process. The Merger Notice, for example, refers to efficiency submissions separately from the detailed requirements set out in relation to the core competitive assessment.
- 2.4 Instead of considering efficiencies as part of the competitive assessment, the "the timely, likely, sufficient" framework is applied separately to the efficiency claims. This is often in an overly prescriptive way, and gives rise to different standards sometimes being applied to the assessment of efficiencies compared to the assessment of whether the merger will give rise to an SLC. These different thresholds for evidence lead to a likely under-identification of the relevant efficiencies and in turn undermines a holistic competitive assessment. We comment further on the various aspects of the current framework for assessing efficiencies below (timeliness, likelihood, and sufficiency). It is important to bear in mind, however, that this should not be a framework that is used to 'balance against' competitive harms – it should be used as part of the overall competitive assessment.
- 2.5 Considering efficiencies as part of the competitive assessment is particularly important in 'dynamic' markets, where competition is more intensely driven by firms' ability to innovate and / or invest in research and development. This is in contrast to more 'static' markets where price is the main parameter of competition and firms make pricing decisions by taking cost structures largely as given. In this context, a staged assessment – first considering whether the merger will reduce competition, and second considering whether the merger will lead to offsetting efficiencies – is more problematic for dynamic markets, because the competitive process itself involves

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<sup>6</sup> MAGs, paragraph 8.3 a).

<sup>7</sup> MAGs, paragraph 8.4.

<sup>8</sup> MAGs, paragraph 8.4.

<sup>9</sup> In the case of Thermo Fisher / Gatan and Illumina / PacBio, the Provisional Findings Report, since these mergers were abandoned before the Final Report stage.

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deciding what investments to make in R&D (both in terms of levels and in terms of what R&D projects to pursue). Efficiencies relating to investment and R&D synergies are therefore directly intertwined with competitive decision-making.

- 2.6 By way of example, consider the assessment of R&D spend levels pre- and post-merger. By taking the competitive assessment in isolation, evidence that the merged firm would reduce its R&D spend compared to the sum of the merging parties' pre-merger spend has been taken as evidence that a horizontal merger would reduce innovation.<sup>10</sup> However, the relationship between a firm's R&D spend and its level of innovation is not necessarily linear. A horizontal merger might affect the level and allocation of R&D spend,<sup>11</sup> but also alter the underlying relationship between R&D spend and innovation if R&D effectiveness increases due to the merger (for example, because of efficiencies). So even if a merger may lead to a reduced total R&D spend (compared to the sum of the spend of the pre-merger firms), this can nevertheless achieve greater levels of innovation than would be achievable by the merging parties independently, for example due to de-duplicating R&D expenditures or aligning R&D expenditure to be complementary. This will ultimately lead to a stronger competitor that enhances rivalry in the relevant market(s). Treating the evaluation of post-merger efficiencies as a core part of the competitive assessment allows this complete picture to be assessed.
- 2.7 The assessment of non-horizontal theories of harm in digital ecosystems similarly illustrates the importance of considering efficiencies as part of the analysis of competitive effects. In such cases, the CMA will investigate whether the merger gives rise to an ability and incentive to foreclose rivals, which may be influenced by factors such as whether cross-selling is enabled through a broader eco-system and whether the merger increases network effects. While such factors are relevant to a foreclosure assessment, they are also potential sources of efficiency and product improvement for customers. A holistic assessment that considers this in the round is more likely to capture the dynamics and full range of effects accurately.

### **3 Whether efficiencies are rivalry-enhancing**

- 3.1 In assessing efficiencies, the CMA seeks to assess whether they are genuinely rivalry-enhancing. In some instances, the CMA has set what appears to be a perhaps inappropriately high bar for efficiencies to be accepted as rivalry-enhancing. We discuss two specific examples of the CMA's assessment of whether efficiencies are rivalry-enhancing in the following paragraphs. (We note that some of the efficiencies discussed below were dismissed by the CMA due to additional factors, as well as its conclusion that they are not rivalry-enhancing. In honing in on the assessment of whether these efficiencies were rivalry-enhancing, we seek to highlight some important general principles, not to imply that the CMA was wrong in specific decisions to reject efficiencies claims).
- 3.2 In Thermo Fisher / Gatan, the merging parties put forward claims that the merger would lead to rivalry-enhancing efficiencies in the form of i) improved maintenance and service and ii) better integrated products with a lower total cost of ownership for customers.<sup>12</sup> Both of these claimed efficiencies were dismissed as not being rivalry-enhancing. This is despite the CMA recognising that customers would value these improvements.<sup>13</sup> The reason behind the CMA's conclusion was

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<sup>10</sup> Illumina/PacBio Phase 2 Provisional Findings Report, paragraph 8.334. Also considered in the European Commission's Dow/DuPont Phase 2 Final Decision, recitals 3144 and 3019.

<sup>11</sup> This has been recognized in Illumina/PacBio Phase 2 Provisional Findings Report, paragraph 8.334.

<sup>12</sup> Thermo Fisher / Gatan Phase 2 Provisional Findings Report, paragraph 13.12.

<sup>13</sup> Thermo Fisher / Gatan Phase 2 Provisional Findings Report, paragraphs 13.35 and 13.44.

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a concern about whether rival firms could replicate the improved / more efficient product offering, given that rivals were reliant on third party suppliers, including Gatan.<sup>14</sup> In other words, it was not enough to show that the merger would cause the merged firm to be more efficient, and therefore a more formidable competitor. Rather, only if rivals can sufficiently respond or even replicate the efficiencies achieved by the merged firm can these efficiencies be judged rivalry-enhancing.

- 3.3 The CMA's conclusion in this regard stems from the fact that the CMA was concerned about vertical foreclosure. The CMA stated that "*given that we have provisionally found that [the merged firm has] the ability and incentive to foreclose smaller rivals, the claimed efficiencies would need to be particularly strong in order to lead to enhanced rivalry from other, smaller firms so as to prevent an SLC arising.*"<sup>15</sup>
- 3.4 Overall, therefore, this line of reasoning has the effect of setting a very high bar for efficiencies to be accepted as rivalry-enhancing in those cases where the CMA is concerned about foreclosure. This is particularly striking in a context where it is well-established that non-horizontal mergers (where foreclosure theories will be of relevance) often provide substantial scope for efficiencies<sup>16</sup> by addressing problematic externalities, such as the elimination of double marginalisation, enabling of relationship-specific incentives like R&D internalisation, improvement in quality control, avoiding 'free-riding', etc.
- 3.5 Of course, concerns about foreclosure may be relevant to the assessment of efficiencies. For example, if the merged firm finds it profitable to pursue a foreclosure strategy, this may mean the merged firm lacks the incentive to pass on its more efficient pricing or to pursue the more attractive product offering. However, it seems better to incorporate this kind of concern through a discussion of sufficiency – rather than to suggest that such efficiencies (lower prices or improved product offerings) are not rivalry-enhancing. If the merged firm becomes more efficient, then regardless of whether rivals can replicate it or not, this should be seen as rivalry-enhancing.
- 3.6 Another relevant example appears in Illumina / PacBio. In this case, one of the claimed efficiencies by the merging parties was the acceleration of innovation, through greater access to capital and support in R&D investment.<sup>17</sup> The CMA accepted that if a greater level of investment was put into PacBio, this would lead to the merged firm developing improved products at a faster rate, but argued that, even if this did occur, this might not be rivalry-enhancing. The CMA reasoned that post-merger R&D investment in PacBio might be redirected towards products which were more complementary to the Illumina, rather than into products which competed with it.<sup>18</sup>
- 3.7 In general, it should not be the case, in our view, that increased but repositioned R&D investment into complementary, rather than substitutable, products is not deemed rivalry-enhancing. Merger synergies which allow for investment to be made across a broader spectrum of research trajectories, through deduplication and repositioning of spend into complementary research lines, should increase overall levels of innovation in a market, and improve the efficiency and competitive strength of the merged firm. As such, in our view, they should in general be considered rivalry-enhancing. There may of course have been specific reasons why the facts in Illumina / PacBio did not support this conclusion, but as a principle, this is important.

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<sup>14</sup> Thermo Fisher / Gatan Phase 2 Provisional Findings Report, paragraphs 13.37 and 13.45.

<sup>15</sup> Thermo Fisher / Gatan Phase 2 Provisional Findings Report, paragraph 13.11.

<sup>16</sup> For example, as set out in the European Commission's 2008 Non-horizontal merger guidelines, paragraph 13.

<sup>17</sup> Illumina / PacBio Phase 2 Provisional Findings Report, paragraph 9.115.

<sup>18</sup> Illumina / PacBio Phase 2 Provisional Findings Report, paragraph 9.117.

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## 4 Timeliness

- 4.1 For efficiencies to play a meaningful role in the competitive assessment, the CMA should adopt a more pragmatic and economically grounded approach to assessing their timeliness.
- 4.2 Although the CMA recognises that efficiencies should be assessed over the same timeframe as the rest of the competitive assessment, it also states that “*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*”.<sup>19</sup> This creates a presumption against efficiencies that take time to emerge, even when longer horizons are the norm for a given sector.
- 4.3 This approach creates an asymmetry in the assessment, particularly in dynamic markets. The CMA regularly relies on forward-looking theories of harm that play out over longer periods – for example, loss of dynamic competition – yet tends to treat longer term efficiencies as insufficiently timely. In dynamic markets, efficiencies often arise from innovation, platform integration, network rollout or R&D pipelines, and therefore mature over multiyear horizons. Discounting them risks understating rivalry in markets where investment cycles are a core part of competition.
- 4.4 The CMA should therefore recognise that efficiencies may be timely even when the resulting enhancement to competitive rivalry occurs over an extended period.
- 4.5 Where efficiencies are expected to materialise over a longer horizon, the CMA could make greater use of time-limited behavioural remedies to protect consumers in the interim. This is consistent with the approach set out in the updated Merger Remedies Guidelines (2025) (“**Remedies Guidelines**”) where it is noted that “*controlling remedies might also be used during a transitional period of a limited duration to prevent harmful outcomes pending the full implementation of a broader remedy*”.<sup>20</sup> For example, we welcome the CMA’s approach in Vodafone/Three, where the CMA adopted transitional measures such as temporary retail price caps and constraints on the merger parties’ wholesale offerings to ensure UK consumers would be safeguarded in the short term, while the merger parties implemented a plan to invest in their networks that would take time to address the SLCs identified.<sup>21</sup> The CMA has clarified the circumstances in which such time-limited remedies are appropriate in the Remedies Guidelines.<sup>22</sup>
- 4.6 To support a more balanced and evidence-based approach, we suggest the CMA places greater weight on evidence that reflects business decision-making. The CMA could draw on deal-related materials – such as board approved integration plans, pre deal investment cases and other internal documents – which the CMA already reviews for the competitive assessment but as we understand it, typically scrutinises less closely in relation to efficiencies, especially at Phase 1. While these documents may not contain all the granularity the CMA might require, the CMA could obtain this through more targeted questions to the merging parties, mirroring its existing approach to competitive effects. For example, the CMA could ask the merging parties to provide their own credible assessment of expected timelines, milestones, and the pathway from internal integration to market roll-out and ensuing customer benefits from increased rivalry. Sector-specific evidence may differ. For instance, in telecoms, relevant milestones might include network coverage levels, latency improvements, defect rates, or rollout locations; in pharmaceuticals, they

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<sup>19</sup> MAGs, paragraph 8.12.

<sup>20</sup> Remedies Guidelines, paragraph 7.37.

<sup>21</sup> Remedies Guidelines, footnote 124.

<sup>22</sup> Remedies Guidelines, paragraphs 3.15, 6.18, 6.31 and 7.37.

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might include R&D stage gates or clinical endpoints; and in manufacturing, metrics could relate to automation upgrades or yield improvements.

## 5 Likelihood

- 5.1 The MAGs state that “*the merger efficiencies must be likely to be realised. This means that the evidence supporting efficiencies needs to be verifiable.*”<sup>23</sup>
- 5.2 Case history suggests that merging parties can find it challenging to produce evidence that meets the bar the CMA has set for likelihood and verifiability. For example, in Illumina / PacBio, Tobii / Smartbox and Sabre / Farelogix the CMA found there was insufficient evidence to demonstrate likelihood.<sup>24</sup>
- 5.3 It should be the case that the balance of probabilities standard is applied consistently to both the question of the likelihood of an efficiency claim materialising and to the question of the likelihood of the merger giving rise to an SLC. The CMA can do this more easily if efficiencies are considered as part of the assessment of whether there is likely to be an SLC as a result of the merger.
- 5.4 Specifically, in dynamic markets, the CMA treats elimination of dynamic competition seriously, even when the likelihood of entry or expansion in the counterfactual is low: “*the elimination of a dynamic competitor that is making efforts towards entry or expansion may lead to an SLC even where entry by that entrant is unlikely and may ultimately be unsuccessful*”.<sup>25</sup> A similar treatment of likelihood should also apply to weighing up claimed efficiencies. If an assessment deems efficiencies to be uncertain to materialise but sizeable if they do, it should in principle be capable of meeting the CMA’s threshold for likelihood, analogous to the approach to potential entry and expansion in dynamic markets.
- 5.5 Moreover, in dynamic settings, evidence on efficiencies from a merger is particularly hard to obtain, making the above situation a common one. The kinds of efficiencies that may be more likely in dynamic settings – such as complementarities in R&D pipelines – are often the most commercially sensitive. As a result, even the merging parties will often not have undertaken the level of detailed analysis to prove that the efficiency is more likely than not to be achieved. However, the merging parties may be able to more accurately assess the size of the potential benefits from the relevant efficiencies, which should be taken into account by the CMA.
- 5.6 In any event, a level of uncertainty is common to any estimated merger synergies related to R&D pipelines and any deal documents which may be available in the ‘clean room’. The information included in ‘clean rooms’ will rarely, if ever, include the two businesses’ R&D pipelines, and the individuals permitted in clean teams would not be from those roles that are well-placed to evaluate any information that is included on potential R&D synergies.
- 5.7 Synergies assessments related to R&D pipelines are therefore usually made by an acquiring firm on the basis of ‘if this the target’s R&D pipeline contains X, this would allow us as a merged firm to do Y’. Deal structures and prices for transactions are agreed under this kind of uncertainty. In its assessment of efficiencies, the CMA should reflect the uncertainty that even merging parties

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<sup>23</sup> MAGs, paragraph 8.13.

<sup>24</sup> Illumina / PacBio Phase 2 Provisional Findings Report, paragraph 9.102; Tobii / Smartbox Phase 2 Final Decision Report, paragraph 8.104 and Sabre / Farelogix Phase 2 Final Decision Report, paragraph 12.23.

<sup>25</sup> MAGs, paragraph 5.23.

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accept when making a decision to proceed with a transaction: these firms face substantial downside risk if efficiencies do not occur and a transaction was over-valued.

- 5.8 Assessing the incentives of the merged firm to pursue efficiencies should also be good evidence that they would be likely to occur. Assessment of these incentives could be conducted using detailed financial and economic modelling, and the CMA could refer to evidence on incentives as part of the topics included in the Merger Notice. Indeed, we note that the CMA has commented on the lack of discussion on incentives in the evidence provided by the merging parties in some cases.<sup>26</sup> Signalling the importance of this evidence as part of its evidence gathering process may therefore help the CMA elicit more useful information.
- 5.9 Of course, it will be important that any incentive assessment should be carried out over an appropriate timeframe, consistent with the features of the industry in question.
- 5.10 We welcome the CMA's position in the Remedies Guidelines that, where efficiencies would benefit UK customers and could prevent an SLC but there remain doubts about their likelihood, "*it might be possible for remedies that secure these efficiencies to resolve the CMA's concerns*".<sup>27</sup> This approach is reflected in *Vodafone/Three*, where the CMA considered that the merging parties were unlikely to realise the full scale of the efficiencies they had claimed,<sup>28</sup> yet accepted that appropriately designed remedies could secure the relevant efficiency commitments<sup>29</sup>.

## 6 Sufficiency

- 6.1 The Call for Evidence asks "*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?*".<sup>30</sup>
- 6.2 If efficiencies are assessed as part of the competitive assessment, the relevant question is less about 'balancing' harms and benefits, but rather assessing how the market(s) will evolve as a result of the merger. For example, in relation to the Call for Evidence's reference to impacts over different time periods, it might be that a short-term SLC is then removed in the longer term, as efficiencies are realised. This is then an issue to grapple with when considering whether and how a temporary SLC should be remedied (e.g., time limited remedies).
- 6.3 In terms of assessing the sufficiency of efficiencies, some evidence may be available in deal-related documents. Diligence assessments by potential buyers will contain structured assessments of the key pillars of a business' valuation and rationale for the acquisition. The operational diligence in particular will usually go through the target business' entire cost base – where the deal rationale includes cost synergies, these should be discussed and assessed as far as possible in the operational diligence. In our experience, such documents are often reviewed by the CMA with more of an eye on assessing factors such as the closeness of competition between the merging parties, rather than reviewed forensically as part of the assessment on efficiencies.

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<sup>26</sup> For example, *Illumina / PacBio Phase 2 Provisional Findings Report*, paragraph 9.102 and *Tobii / Smartbox Phase 2 Final Decision Report*, paragraph 8.104.

<sup>27</sup> Remedies Guidelines, paragraph 7.17.

<sup>28</sup> *Vodafone / Three Phase 2 Final Decision Report*, paragraphs 16.177 and 16.706.

<sup>29</sup> *Vodafone / Three Phase 2 Final Decision Report*, paragraph 75.

<sup>30</sup> Call for Evidence, Figure 1, question 2(b).

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- 6.4 However, it is also important to recognise that deal-related documents may in many instances not contain the specific information, to the required level of detail, to meet the CMA's approach to legal tests to date. In this regard, this is something that the merging parties and their advisors can seek to supplement through bespoke analysis of efficiencies, which will provide richer evidence for the CMA to scrutinise. If there were clearer readiness on the CMA's part to accept efficiencies where appropriate (through some of the other changes we refer to in this response, for example), merging parties would have a greater incentive to invest the time and effort on such analyses, in what are already resource-intensive and time-pressured M&A processes.

## 7 Merger specificity

- 7.1 The MAGs state that "*The CMA will assess whether the merger efficiencies are reliant on the merger in question or whether they would be brought about by other means.*"<sup>31</sup> In practice, a lack of reliance on the merger in question – i.e., a lack of merger specificity – is one of the most common grounds upon which efficiency claims are rejected by the CMA.
- 7.2 For example, in each of Sabre / Farelogix, Thermo Fisher / Gatan, Microsoft / Activision, Illumina / PacBio, and JD Sports / Footasylum, claimed efficiencies were concluded to not be merger-specific. The CMA's analysis of merger specificity is in most cases relatively brief, and does not include an in-depth assessment of alternative mechanisms for delivering the claimed efficiencies, and their pros and cons compared to the merger.
- 7.3 In our view, the bar for establishing merger specificity, implicitly set by the CMA through its decisional practice, has been too high. The standard for demonstrating merger specificity should not be that the efficiency can *only* be realised via the merger. Rather, a practical assessment should be made, and if the merger is the best, most likely and/or most timely way to realise an efficiency that should carry weight. A useful sense check on the CMA's assessment of merger specificity is the consideration of the counterfactual – if an efficiency is not likely enough to happen without the merger to form part of the CMA's counterfactual, or if it would be materially delayed in the counterfactual, then that should provide at least an indication that it is likely to be merger-specific.
- 7.4 A notable example of a more practical assessment by the CMA was in Sainsbury's / Asda, where the CMA found that, although alternative mechanisms to the merger may exist for the merging parties to realise proposed efficiencies (procurement synergies), the CMA recognised the "*difficulties and limitations*" of these alternative approaches. The CMA concluded that the merger was the least costly way for the merging parties to realise these efficiencies, and that the efficiencies were therefore merger-specific.<sup>32</sup>
- 7.5 As also discussed in relation to demonstrating likelihood, a consideration of incentives of the merging parties / merged firm with and without the merger should provide important evidence for assessing merger specificity. If the incentive to execute the efficiency post-merger is greater than in the counterfactual, this should carry weight for demonstrating merger specificity (alongside a consideration of ability). Again, the CMA could signal to merging parties that this

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<sup>31</sup> MAGs paragraph 8.16.

<sup>32</sup> Sainsbury's / Asda Phase 2 Final Decision Report, paragraphs 16.197 – 16.199. While the CMA accepted the efficiencies as merger-specific they ultimately concluded that they were not of sufficient scale to fully counteract the upward pricing pressure it thought would arise as a result of the merger.

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kind of evidence would be highly relevant, and seek to obtain more detailed submissions on this topic as part of the evidence gathering process.

7.6 The CMA should also be alive to the practical challenges associated with alternative means of delivering efficiencies, and seek to gather evidence on the relative costs or barriers to delivering efficiencies through a merger versus other means.

7.7 Various forms of contracts or agreements between the merging parties are in some instances suggested by the CMA as an alternative feasible means of achieving efficiencies without a merger. See for example, *JD / Footasylum and Sainsbury's / Asda*.<sup>33</sup> Yet economic theory indicates a number of challenges to contracts being able to replicate efficiencies that would be enabled by a merger:

(a) Contracts are incomplete,<sup>34</sup> meaning that there are contingencies that cannot be foreseen, and even if they could, it would not be feasible to write all contingencies into contracts. Enforcement of contracts may also be incomplete, as courts or arbitration bodies need to both understand the terms of a contract and verify whether or not a contract has been breached. The risks from incomplete contracts may in turn lead to a contract not being agreed between parties, or not being agreed in a timely manner, putting efficiencies at risk.

(b) There may also be frictions between organisations with different management, especially where there is a vertical relationship between the organisations. Incentives may differ between the organisations, for example as seen in principal-agent scenarios, especially where the principal does not have full information on the activity of the agent, as indeed would typically be the case between two contracting firms.<sup>35</sup> Contractual arrangements can lead to different outcomes than bringing both organisations under single ownership,<sup>36</sup> and hence if a contracting option is proposed as an alternative to merger, this would need to be carefully examined in order to assess whether this would indeed be likely to lead to efficiencies of similar likelihood, timeliness and magnitude to those enabled by the merger.

7.8 The CMA is, of course, alive to the inherent challenges and risks associated with contractual or other agreements, as is evident in its careful consideration of whether behavioural remedies, involving commitments or other agreements made by the merged firm, are appropriate. A similarly careful and cautious approach in assessing non-merger means of achieving efficiencies would be appropriate.

7.9 More generally, there are clear reasons why firms choose a merger as a preferred method for achieving efficiencies: our experience advising firms indicates that often a transaction can be the most certain way to bring about efficiencies. In particular, the following features of a merger decrease the risk of efficiencies not being implemented:

(a) Clear oversight and ownership enabled by a single entity responsible, with a merger removing the frictions that can arise when organisations need to coordinate. This is in line

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<sup>33</sup> *Sainsbury's / Asda Phase 2 Final Decision Report*, paragraphs 16.197 – 16.199 and *JD / Footasylum Phase 2 Final Decision Report (before Remittal)*, paragraph 11.75.

<sup>34</sup> See Tirole, J. (1999) 'Incomplete contracts: where do we stand?', *Econometrica*, Vol. 67, No. 4, pp. 743-744.

<sup>35</sup> For example, see Holstrom, B. and Milgrom, P. (1991), 'Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design', *Journal of Law, Economics, & Organization*, Vol. 7, Special Issue.

<sup>36</sup> For example, as seen in Grossman, S.J. and Hart, O.D. (1986), 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration', *Journal of Political Economy*, Vol. 94, No. 4.

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with reasons why firms in our experience may pursue JVs for specific projects, rather than operating as consortia of independent entities.

- (b) Relatedly, a merger does not rely on contractual arrangements between multiple parties. In line with economic theory, as mentioned above, contracts are imperfect and cannot cover every eventuality. Additionally, absent a merger, there is a risk of contractual disputes which may deter or delay efficiencies being introduced.
- (c) Financing for a project that will deliver efficiencies may also be more readily achievable – or offered on better terms – for a merged firm, rather than two independent entities tied via contract. This may lead to a project that otherwise would not reach a firm’s internal hurdle rate to pursue now becoming worthwhile. In cases where efficiencies might relate to investment in new product lines or investing in nascent product lines of the target business, this practical constraint on financing in the absence of a merger should be particularly relevant to the CMA’s assessment.

## **8 Whether efficiencies will benefit consumers**

- 8.1 Our suggested approach of integrating rivalry-enhancing efficiencies into the competitive assessment would also make it easier for the CMA to assess whether and how those efficiencies are likely to be passed on to consumers. Two areas where this applies in particular are 1) the consideration of pass-through of the relevant changes driven by the merger, and 2) the consideration of consumer benefits when they lie outside the relevant market(s) but are directly linked to the merger.
- 8.2 When considering pass-through of efficiencies, the CMA should apply the same analytical tools it typically relies on in other contexts, including evidence about market structure, historic pass-through of cost shocks or quality improvements, econometric evidence, and the nature of the efficiency itself (for example, whether it affects marginal costs, fixed costs, quality or innovation). Assessing pass-through as part of the overall competitive assessment would avoid placing disproportionate evidential burdens on the merging parties and provide a more accurate view of the merger’s impact on rivalry.
- 8.3 Where pass-through of efficiencies is plausible but uncertain, the CMA might consider requiring targeted commitments to secure the anticipated benefits. For instance, the merging parties could commit to a set of KPIs and/or transparency measures for a defined period, giving the CMA confidence that efficiencies are being delivered. This approach would be consistent with the Remedies Guidelines, which recognise that certain remedies can help lock-in efficiencies where appropriate.<sup>37</sup>
- 8.4 The CMA should also avoid automatically excluding benefits that arise outside the relevant market. In some circumstances, efficiencies may occur in adjacent, linked or ecosystem-type markets, where improvements in one part of a multi-product offering enhance rivalry overall. Where these markets are closely connected and customers experience the benefits directly or indirectly, such efficiencies should form part of the competitive assessment. Only where benefits arise in wholly separate and unrelated markets – with no link to the competitive dynamics under review – would

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<sup>37</sup> Remedies Guidelines, paragraphs 7.17 and 7.18.

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it be more appropriate to consider them in the round through the RCB framework rather than the competitive assessment.

- 8.5 This approach is particularly relevant in ecosystem settings or for multi-product retailers, where improvements in one component of an integrated offering can strengthen competition across the system as a whole. Excluding such efficiencies merely because they sit outside a more narrowly-defined relevant market would risk understating a merger's overall pro-competitive effects.