CMA Merger Efficiencies Review: Call for Evidence

UK Finance Response

1 Introduction and executive summary

(1) UK Finance welcomes the opportunity to respond to the Competition and Markets Authority's (**CMA**) Call for Evidence (CfE) on its approach to assessing rivalry-enhancing efficiencies. This CfE is important to our Corporate Finance Committee members ("members") who advise clients active in mergers and acquisitions ("M&A"). This response was prepared with the advisory support of Linklaters LLP.

(2) UK Finance supports the CMA's ongoing efforts to deliver its '4Ps' framework across its merger control function, including in respect of merger efficiencies. We further support the CMA's broader strategic objective to instil business confidence and drive investment, innovation and growth in the UK.

(3) We do not respond to all of the questions in the CMA's CfE in this submission. Instead, we provide a more targeted response in respect of Theme 1(b) of the consultation (the evidence base for efficiencies) where we think we can bring our experience (and that of our members) to bear to assist the CMA in its review.

(4) Merger synergies are a key driver of M&A activity and can often create significant efficiencies, which benefit consumers, in particular rivalry-enhancing efficiencies. As explained below, members encourage the CMA to be open to placing weight on the merging parties' own synergies analysis (supplemented by other sources of evidence as appropriate).

2 Theme 1(b): The evidence base

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

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

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

(5) As the CMA recognises in its CfE, most information relating to merger efficiencies, such as cost and revenue synergies, is held by the merging parties. At the same time, in our members' experience, the CMA has typically viewed merging parties' synergies assessments with a degree of scepticism, potentially concerned that these are at risk of being self-serving. We would urge the CMA to proactively engage with, and give more weight to, the merging parties' synergies assessments in future.

(6) First, synergies assessments are produced in contemplation of a transaction and are therefore by definition merger specific. They offer, in our view, one of the best sources of evidence for both identifying and quantifying the efficiencies that can be derived from a merger. This is contrast to other (pre-merger) internal documents of the parties which are very unlikely to directly inform the CMA's assessment of merger efficiencies, will have been produced for a whole range of disparate purposes, and may have been subject to varying degrees of internal or external review.

(7) Second, merging parties, supported by their professional advisors, invest significant resource and expertise into the assessment of merger synergies as part of general due diligence and deal valuation. These are key points which convince merging parties to do a deal. However, there are good reasons why the full benefits the parties might believe could be derived from a combination may not be present in deal approvals or public announcements. These may include for example confidentiality or commercial sensitivities as well as possible antitrust considerations limiting information flows between parties (particularly given stringent requirements applicable to public M&A). We think these assessments – including assessments that are not included in deal approval documents or public announcements – should be given significant weight in substantiating the merging parties' efficiency claims before the CMA.

(8) In public M&A in particular, merging parties are subject to stringent requirements on what can be included in deal approvals and communicated to shareholders and the public. This means estimates in such documents are necessarily conservative. The restrictions include the fact that:

(a) Arriving at a synergy valuation typically involves building a detailed, bottom-up model of cost, revenue and other synergies, requiring input from a broad range of business functions, benchmarking and empirical data, with third-party validation being mandated by regulation or an option available to underpin the directors' duties. This is necessary because directors must comply with their statutory duties including to

promote the success of their respective company for the benefit of its shareholders as a whole and to exercise reasonable care, skill and diligence.

(b) Where UK listed companies undertake significant transactions, the Listing Rules further require that any estimated synergies or other quantified financial benefits are backed up with disclosure of the basis of the directors' belief and an explanation of the constituent elements of such estimates, further emphasising the need for directors to make such statements with due care and diligence.

(c) In respect of public M&A, the UK Takeover Code also requires that all statements, including in respect of synergies and intentions for target business, must be prepared with the highest standards of care and accuracy. Furthermore, where a target company, or a bidder offering share consideration, makes quantified financial benefit statements, its external advisors play a key role in their validation:

i. its reporting accountants must report that they have been properly compiled on the basis stated; and

ii. its investment bank will test and review the synergy assumptions and must report that the estimates have been prepared with due care and attention.

(e) Other jurisdictions deploy similar methods of validation, for example fairness opinions on synergy benefits statements in relation to US proxy statements.

(9) In our members' experience, the cumulative impact of these statements is that expected efficiencies are typically communicated on a highly conservative basis. In addition, any more speculative but potentially significant benefits derived from for example combination of R&D / innovation capabilities are often excluded entirely from such announcements.

(10) Our members recognise that the CMA may be hesitant to rely solely or very extensively on the merging parties' own synergies assessment or may consider there are areas where further evidence is required. However, in those circumstances, additional sources of evidence, for example industry or economic expert reports may be relied on as a supplement or cross-check to the merging parties' own assessment.

(11) Additionally, members note that synergies assessments are often subject to various assumptions and caveats. This does not mean that they cannot offer

credible or robust evidence. Instead, it reflects the fact that the assessment, like the CMA's own merger assessment, is necessarily forward-looking and predictive. Members recognise that, where the CMA identifies material gaps or deficiencies in the merging parties' analysis in terms of evidencing (rivalry-enhancing efficiencies (as opposed to synergies) then this should appropriately be considered in the weighting of that evidence by the CMA, but such evidence should not be dismissed outright without proper consideration.

(12) If the CMA has any questions or would like to further discuss the points raised in this submission, please contact avanthi.weerasinghe@ukfinance.org.uk

About UK Finance

Representing 300 firms, we are a centre of trust, expertise and collaboration at the heart of financial services. Championing a thriving sector and building a better society. The financial services industry plays a vital and often underappreciated role enabling individuals, families and communities to achieve their ambitions in a safe and sustainable way – through home ownership, starting a new business or saving for retirement. The sector is fundamental to people's lives, and we are proud to promote the work it is doing to support customers and businesses up and down the country.

Whether it is through innovating for the future, driving economic growth, helping struggling customers amid increases in the cost of living, fighting economic crime or working to finance the net zero transition – the industry is having an overwhelmingly positive effect on the lives of people across the UK and improving the society we live in. Further information is available at: www.ukfinance.org.uk

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About Linklaters

Highly regarded for its in-depth technical knowledge, innovative tactical input and involvement in the most high-profile merger control cases, Linklaters' Antitrust and Foreign Investment Group is known for providing pragmatic, business-oriented advice. Our top-tier team of experts have a market-leading track record of handling the most challenging antitrust issues in M&A, across the UK, EU and worldwide. Further information is available at www.linklaters.com

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