

## **Estimated costs to consumers of the mergers against which the CC took action between March 2005 and March 2006**

*Competition Commission July 2006*

The Competition Commission seeks to evaluate its effectiveness in a number of ways, including quantification of the additional costs that consumers in the UK might be expected to incur were it not for our decisions. This note summarises the derivation of the estimates of these costs for the four mergers against which the CC took action, between March 2005 and March 2006. The total, plus an estimate for a market investigation reporting in the same period, is to be published in the Chief Executive's review in the CC's annual report for 2005/06.

### ***Our approach***

In making the estimate, we recognise that our approach is partial in scope and subject to considerable uncertainties in its application.

It is partial in scope, in that it measures the value only of CC decisions to take action against proposed mergers. Decisions to clear mergers can also provide economic benefits to consumers and to the economy generally, although those benefits will be harder to measure (because merger-specific benefits such as cost savings may be hard to verify and there are more diffuse benefits arising from the existence of an active capital market, that are not specific to a given merger). In addition, many possible mergers that would produce anticompetitive effects will simply never be proposed, as a result of the deterrent effect of the existence of merger control in competition law and institutions such as the CC that enforce it. More generally, these estimates take no account of other aspects of the merger control process, such as the OFT's actions<sup>1</sup>.

It would not be appropriate to use these measures as a performance standard for the CC, because they are almost entirely outside the CC's control. The principal determinant of the avoided costs to consumers is the turnover of the sector or company involved. The CC cannot prioritise cases by this measure, as it has no control over the cases referred to it. In part, this limitation on the usefulness of the measure derives directly from the simplifying decision only to look at the costs avoided by the CC's adverse findings. The value delivered by the CC's detailed investigations might instead be assessed against an alternative institutional structure for merger control (such as reliance solely on the OFT's 'Stage 1' assessments). We are working to develop the scope of our analysis to make these estimates for future years more sophisticated.

In the relatively simple framework we have adopted here, we seek to identify the likely price rises or other consumer detriment arising from the expected substantial lessening of competition, had the mergers that the CC sought to remedy been allowed to proceed without remedy. The practical difficulty is that such price rises represent predictions, in effect, of a future that now will not happen. We have sought to determine a 'best guess' derived from all the information available to the CC for each case. We do not adopt a single methodology in each case; rather we seek to

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<sup>1</sup> The OFT has produced its own estimates, aiming to set a floor on the likely value of its actions by taking a deliberately conservative estimate of the costs that would have resulted from allowing mergers to proceed. We are working with the OFT to develop a common approach for future analysis, to cover the UK merger control regime as a whole.

capture what the team conducting that investigation believed was the likely effect of the merger. Because the CC's cases are all different, different approaches therefore emerge for different cases in this evaluation.

### **Summary of findings**

The CC reached SLC findings in four merger inquiries completed between March 2005 and March 2006: Serviced Dispense Equipment Limited (SDEL)/Coors Brewers Limited (Coors), Somerfield plc (Somerfield)/Wm Morrison Supermarkets plc (Morrisons), London Stock Exchange plc (LSE)/Euronext N.V. (Euronext)/Deutsche Borse AG (DBAG) and Vue Entertainment Holdings (UK) Limited (Vue)/A3 Cinema Limited (including its subsidiary, Ster Century (UK) Limited (Ster). The final reports on each of these mergers is available on the CC web site.<sup>2</sup>

We estimate that the total costs to UK consumers had these four mergers been allowed to proceed without remedy would have been in the order of £31.5 million per annum, made up as follows:

Inquiry	Estimated costs to consumers per annum (£ million)
SDEL/Coors	13.9
Somerfield/Morrisons	5.5
LSE/Euronext/Deutsche Borse	11.8
Vue/Ster	0.3
Total	31.5

In calculating a total cost to consumers we have assumed that these adverse effects would have lasted for at least 3 years. In addition to this activity relating to mergers, the Competition Commission reported on one market investigation in this period: Store Card Credit Services (Store cards). In the final report on the Store cards market investigation<sup>3</sup>, we estimated that over the period since 1999, customer detriment from the adverse effect on competition we identified has been at least £55m a year, and possibly significantly more.

### **Summaries of cases**

#### *SDEL/Coors*

This merger<sup>4</sup> concerned the equipment used to dispense beer and some other drinks in pubs and elsewhere (Technical Services Equipment: TSE), along with associated services such as maintenance (Technical Services: TS). SDEL was a joint venture of the TS and TSE businesses of two of the largest brewers. In the proposed merger referred to the CC, another large brewer, Coors, proposed to join this joint venture.

The CC found that the deal would be likely to create an SLC in the TS and TSE markets and prohibited the merger.

<sup>2</sup> Note that the summaries set out below are not intended to be complete, but merely attempt to put the quantifications in context. The final reports remain the authoritative statement of the CC's findings.

<sup>3</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2006/509storecards.htm](http://www.competition-commission.org.uk/rep_pub/reports/2006/509storecards.htm)

<sup>4</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2005/499sdel\\_coors.htm](http://www.competition-commission.org.uk/rep_pub/reports/2005/499sdel_coors.htm)

Assessment of the likely costs of the merger was particularly difficult in this case, as TS and TSE are not generally sold or priced separately from beer supplied in barrels to pubs and other outlets. Thus, even the value of total TS and TSE sales was uncertain. The CC had particular concerns about quality deterioration in TSE and higher prices for TS. Given the value of SDEL's and Coors's TSE installed base of £191m, even a conservative 1% value loss per annum due to quality deterioration implies a cost to consumers per annum of £1.9m. We estimated that the price of a barrel of beer (around £200) from each of the three brewers involved in the deal might rise by about £1 if the merger were to proceed, implying higher prices of £12m per annum in the UK. Thus, the total cost to consumers of allowing the merger to proceed was, for the purposes of this evaluation, estimated at £13.9m per annum.

#### *Somerfield/Morrisons*

This case<sup>5</sup> concerned the sale of 115 grocery stores, mostly in the 'mid range' size between convenience stores and large one-stop shops, from Morrisons to Somerfield. Both parties are supermarket chains (although Somerfield is significantly smaller than the largest four supermarket chains), and the transfer represented a relatively trivial change to national market shares. However, the CC determined that the relevant markets were local, in that a provider with local market power could raise prices or reduce quality (including range of goods sold, and service) at its stores in that location. The CC therefore examined the 115 locations individually, and determined that an SLC would be likely to occur in 12. Somerfield was required to divest stores in the 12 locations, to restore competition.

In this evaluation, we calculated the additional costs that consumers would otherwise have faced, at 5% of the revenue of all Somerfield stores in the affected location (including the acquired ex-Morrisons store). The CC in its report did not think that the adverse effects resulting from the merger in these locations would necessarily take the form of price rises but might instead involve reductions in quality, range and service. The estimates should be considered, therefore, to represent proxies for such less tangible detriments: a 5% reduction in attractiveness to consumers. We note that the estimate does not include any price rises (or quality loss) at stores owned by firms other than Somerfield, although generally we would expect such a lessening of competition to have some such effect on all stores within the local market.

This method produces an estimated cost to consumers across the 12 affected areas of £5.5m per annum.

#### *LSE/Euronext/Deutsche Borse*

This case<sup>6</sup> involved two separate bids for the LSE. The CC determined that each would be likely to result in an SLC within the market for the provision of on-book equities trading services within the UK because of the ability and incentive to foreclose entry or expansion to other providers of trading services. The CC did not prohibit the mergers, but instead imposed conditions on the two bids, relating to structural remedies (reduced ownership stakes in businesses the ownership of which provided the bidders with an incentive to foreclose competitors) and behavioural remedies.

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<sup>5</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2005/501somerfield.htm](http://www.competition-commission.org.uk/rep_pub/reports/2005/501somerfield.htm)

<sup>6</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2005/504lse.htm](http://www.competition-commission.org.uk/rep_pub/reports/2005/504lse.htm)

For the purposes of this evaluation we use as a base the situation in which either merger had taken place without undertakings. We note, however, that we cannot be sure that either of the “mergers in contemplation” would have materialised in practice, had the CC not investigated. At the time of writing, the market is still in flux and it is not clear who (if anyone) will buy the LSE. For simplicity, we have therefore assumed that the comparison is between the unremedied mergers and no merger at all.

On the basis of LSE’s internal documents identifying competitive constraints arising from potential competition from other stock exchanges, we estimated for the purpose of this evaluation that either merger would have been likely to result in an increase in fees of around 11.8%. Since LSE’s annual revenue from trading services is around £100m, the unremedied mergers would therefore have resulted in an estimated loss to consumers annually of around £11.8m.

### *Vue/Ster*

In this small case<sup>7</sup>, the CC examined a deal involving the transfer of six cinemas in the UK from Ster to Vue. The effect on the national market was not material, but the CC determined that competition (on price and quality) took place in local markets. The CC therefore examined the six local markets individually, and concluded that there would be likely to be an SLC in one, in Basingstoke. The CC therefore required the divestment by Vue of the cinema in Basingstoke acquired in the deal.

For this evaluation, we looked at data on cinema prices in Basingstoke. For six years of our data set, there was a single monopoly cinema owner in Basingstoke. There was then a three year period of competition between two independently owned cinemas, before the deal under investigation recreated the local monopoly. Prices rose more quickly under monopoly than under competition. We therefore took the difference between the two to represent the likely additional price rises annually that would have resulted had the merger been allowed to proceed. This is quite substantial in percentage terms (4.5% annually), but given the size of the business results in a relatively small total cost of £0.3m annually.

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<sup>7</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2006/508vue.htm](http://www.competition-commission.org.uk/rep_pub/reports/2006/508vue.htm)