

Estimated costs to consumers of mergers and market outcomes against which the CC took action between April 2007 and March 2008

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The Competition Commission (CC) 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 summarizes the derivation of the estimates of these costs for the five mergers against which the CC took action, the one market investigation and the one regulatory investigation on which the CC reported, between April 2007 and March 2008.

Where the CC finds such a detriment—for example, when consumers are expected to pay higher prices or receive lower quality than they would have done had competition been fully effective—it takes action to remedy it. This note only seeks to quantify the detriment, not the remedial action. Remedies will not necessarily be in place yet for all the adverse findings in this financial year (during this year the CC has implemented remedies relating to detriments found in previous years). More fundamentally, it might be that some remedies are less effective than others. The CC seeks to assess effectiveness of remedies periodically, by looking back at past cases, but this is obviously not possible for recently completed cases.

This is the third year for which the CC has produced an estimate of customer detriments in this way. It uses the same methodology as was employed in 2006/07 for its own work, but we have now agreed a comprehensive system for joint reporting of work carried out in conjunction with the Office of Fair Trading (OFT).

Our approach

In making this estimate of consumer detriment, we recognize 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 or to remedy markets. Where it finds no detriment, the CC clears mergers or markets. These clearance decisions will also provide economic benefits to consumers and to the economy generally, although those benefits will be harder to measure (for example, for mergers the 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. The total value reported here is a very partial measure of the value of the competition regime, which happens to be easier to calculate than these wider measures.

The scale of the sectors within which detriments arise will have a strong influence on the overall estimated detriment. Some other authorities recognize this explicitly by simply taking annual merger detriment to be, for example, 1 per cent of the total turnover of the sectors examined. Our approach to estimation is more complex, but the same basic scaling point applies: other things being equal, a detriment arising in a market with ten times the turnover of another is likely to be about ten times as great. Cases examined by the CC in 2007/08

included for example the acquisition of a company¹ with an annual turnover in the UK of less than £400k at one extreme, and the BAA Airports market investigation into a sector with a turnover over £2.5 billion—more than six thousand times larger—at the other. The CC does not determine which sectors are referred to it, and consequently any estimate of customer detriment found is uncontrollable and highly unstable from year to year.²

For **mergers**, we seek to identify the likely price rises or other consumer detriment that would have arisen had the CC not acted against the merger. 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 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.

For **market investigations**, the analysis is typically more backward-looking. Adverse findings in these investigations relate to features of the market that already exist, and calculations of the detriment arising typically relate to the last few years. In principle, it is possible that problems will to some extent be self-correcting, so that this overestimates the detriment that would have arisen without CC action, going forward. Equally, however, in some cases the detriment might be increasing and this backward-looking estimate will under-state the ongoing detriment that consumers would otherwise have experienced. Again, the methodology in each case is highly specific to that case (and, unlike mergers, often forms a part of the CC’s investigation at the time and, if so, is set out in the published report).

The CC completed two **regulatory investigations** in 2007/08, one relating to the Civil Aviation Authority’s (CAA) proposed price controls for Heathrow and Gatwick and the other to an appeal against Ofgem’s decision on a modification to the Gas network code. We considered carefully whether to include estimated detriments for these cases, or some other measure of the CC’s effectiveness. In a sense, there are two sides to most regulatory cases and the CC’s role is, formally or informally, as an appeal body. A decision to support a tight price control should be no more valuable than a decision to support a looser price control. Simply measuring ‘consumer detriment avoided’ would therefore be inappropriate. In principle, the benefit of the CC’s work in such cases arises both from the better-focused regulation applied in each case following the decision, and perhaps more importantly from the confidence created by the existence of an impartial arbiter. We have not been able to identify a means of quantifying these benefits, **and accordingly we have not estimated any value arising from the CC’s two regulatory decisions in 2007/08.**

One system with two authorities

All of the CC’s casework results from references from other bodies. In particular, the Enterprise Act 2002 provides for a single system for merger control and a single system for market investigations, both administered jointly by two bodies: the CC and the OFT. For mergers, customer detriment is avoided when the CC remedies a Substantial Lessening of Competition (SLC) finding, but also if the OFT is able to avoid a reference because merging parties can offer acceptable undertakings preventing an SLC arising, or if the merger is abandoned. For markets, the OFT carries out considerable work before a reference is made, and in some cases is also able to agree undertakings in lieu of a reference. The OFT has a role in monitoring the CC’s remedies for both mergers and market investigations.

¹Thermo Electron Manufacturing Limited / GV Instruments Limited.

²This year’s estimate is significantly higher than that for previous years, but this is essentially driven by one merger decision in a very large sector: BSKYB/ITV.

We therefore present a combined figure for the work of the OFT and CC in these shared activities, using the CC figures reported here and the OFT's estimates reported in its annual *Positive Impact*³ statement. Although a single combined figure is the only meaningful way to report the effects of the single system, on occasion it might be necessary to split the benefits between the two bodies. When doing so, we have agreed to use an 80:20 rule: the authority principally responsible for the decision is allocated 80 per cent, the 'secondary' authority 20 per cent. This roughly corresponds to the proportions of cost incurred in a merger referred to the CC, with the same proportions used for other activities for simplicity.

³Available, annually, at http://www.of.gov.uk/advice_and_resources/resource_base/evaluation/publications. There are some differences between the way the two bodies have summarized the figures (for example, the OFT reports three year averages, the CC focuses on the within-year figures). Not all figures are immediately comparable, therefore, but they are consistent and derived from the same data. The CC has now decided to align its reporting approach with that of the OFT next year, so all numbers for 2008/09 will be directly comparable.

Summary of findings

The CC reached SLC findings in four merger inquiries under the Enterprise Act 2002, and also found against a merger referred under the Water Act 1991. In addition, it reached a finding of 'adverse effects on competition' in a market investigation, made recommendations to the CAA on price controls for Heathrow and Gatwick airports and rejected an Ofgem modification of the Uniform Network Code in the gas industry. All the reports are available on the CC website.

Note that adverse findings do not have to relate to the entire sector, or to all the investigated industries' activities, in either merger or market inquiries. An SLC relating only to one small part of a merger would still be an 'SLC finding' overall, in which case the estimated detriment would likely be small.

We estimate that the total costs to UK consumers had the **five mergers** been allowed to proceed without remedy would have been in the order of £280 million a year, made up as follows:

Merger inquiry	Estimated detriment to consumers a year <i>£ million</i>
Thermo/GV Instruments	0.2
Kemira/Terra	6
Macquarie/National Grid	30
Mid Kent Water/South East Water	1
BSkyB/ITV ⁴	242
Total	279

The CC and the OFT together operate a single system of merger control. Any benefits considered to arise from the system of merger control as a whole should be compared with the total combined costs of the system. The OFT has estimated savings from undertakings in lieu of a CC reference and cancelled mergers of £23 million in 2007/08,⁵ so total detriment to consumers avoided as a result of the merger regime was £302 million.

The CC completed one market investigation under the Enterprise Act: Northern Irish Personal Banking. The estimated costs to consumers avoided as a result of this decision was estimated at £12–24 million annually (mid-point £18 million).

In addition, the CC and the OFT together reviewed undertakings relating to a previous CC investigation into banking services for small- and medium-sized enterprises ('SME banking') and the CC decided to lift temporary price controls, following a report by the OFT. The OFT has estimated⁶ the value to consumers of this timely decision to remove controls at £50 million in total, annualized to £17 million. So, we estimate the total annual detriment to

⁴At the time of publication, the CC's decision on BSKyB/ITV was being considered by the Competition Appeals Tribunal, following applications for judicial review by BSKyB and by Virgin. The assessment should therefore be regarded as provisional.

⁵This is an annualized figure from an OFT three-year total.

⁶On the basis of increased switching to smaller banks. See *Positive Impact 07/08*, at:

http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/of1007.pdf for this and other OFT calculations.

consumers avoided as a result of the market investigation decisions taken this year to be £35 million.

For mergers and markets combined, we therefore estimate total consumer detriments avoided as a result of the CC and OFT's work at £336 million. We do not attempt to forecast the duration over which these detriments would have occurred, but it will be significantly more than a year. As a simple approach to estimating the total over time, we multiply this figure by three, **resulting in a total detriment avoided of £1009 million as a result of the CC and OFT's work in this year.**⁷

We regard this joint figure as the most representative of activity, and any allocation between the two bodies as somewhat arbitrary. However, were it necessary to allocate the figure above between the two bodies, then we allocate 80 per cent of its own merger and market decisions to the CC and 20 per cent of undertakings in lieu, cancelled mergers and the review of undertakings to the CC. This results in a total figure for the CC of £736 million.

⁷Excluding, for the CC, the two regulatory inquiries for which we have not been able to estimate a value, and excluding the very broad range of OFT work which does not involve the CC (reported separately in *Positive Impact 07/08*).

Summaries of cases

We provide below short summaries of how the avoided customer detriment was calculated in each of the cases cited here. Note that the summaries set out below are not intended to be complete, but merely attempt to put the quantifications in context. In most cases, these calculations were carried out after the inquiry report was published, and form no part of the CC's decision. The final reports, available on the CC website,⁸ remain the authoritative statement of the CC's findings.

Figures used in the calculations are often commercially confidential and cannot be reported. These figures have been excised, indicated using square brackets. Often, to estimate the detriment we need to multiply a commercially confidential number by—for example—a percentage price rise. Because we report the product of this calculation, we have also had to excise the percentage rise in such cases, to preserve the confidentiality of these revenue figures.

Mergers

Thermo/GV

GVI and Thermo are the two largest suppliers of Isotope Ratio Mass Spectrometry (IRMS) instruments. The CC found an SLC relating to the Gas IRMS and TIMS markets. In the Gas IRMS market the merger substantially reinforced Thermo's market-leading position whilst in the TIMS market, the merger resulted in the number of competitors being reduced from two (GVI and Thermo) to one, the merged entity. The CC considered that the merger, compared with the counterfactual, would enable Thermo to increase prices or engage in other conduct likely to affect customers adversely, such as to reduced product development and service levels.

The case team believed that post merger Thermo had the ability to increase prices by approximately [5–10] per cent as a result of the merger. Thermo had a monopoly position in the TIMS market prices but the case team believed prices were unlikely to go up higher than [5–10] per cent given that there is some possibility of substitution between TIMS and MC-ICP-MS. For Gas IRMS, the case team also believed that prices were unlikely to go up higher than [5–10] per cent given the prospect of Nu's entry. This equates to an estimated UK detriment of £0.23 million, although the worldwide detriment would be more than ten times this figure. The detriment calculation has not incorporated a figure for the potential reduction in product development and service levels.

Mid Kent Water/SE Water

This was a merger between two regulated water companies. There is little competition in the water industry, but the ability of the regulator (Ofwat) to protect customers' interests and promote efficiency through price controls depends to some extent on there being enough companies to act as comparators to one another. The CC found that the takeover of Mid-Kent water would prejudice Ofwat's ability to make comparisons in some respects. Assessing the likely effect was highly uncertain, because the prejudice related principally to the *certainty* with which Ofwat could measure that companies were relatively inefficient, rather than a prejudice to that measure itself (as might have arisen had a particularly efficient

⁸<http://www.competition-commission.org.uk/inquiries/completed/index.htm>. In this document, we take the date of publication of the final report as the date at which we quantify the effects. However, sometimes cases do not conclude until some time after the final report. The files might then be on the CC website under a later year than reported here, or even under 'current investigations'.

company been removed from the comparator set). In its final report, the CC estimated the detriment to customers as being between £1 million to £10 million over a five-year price control period. For the purposes of producing a point estimate, we here report the mid-point figure of £5 million over the period, or £1 million annually. We note that Ofwat also had concerns about less quantifiable effects arising from the loss of a comparator, so this figure should be regarded as a conservative estimate.

Kemira/Terra

This was a joint venture (JV) between two producers of fertilizers. The parties overlapped in a number of product areas and the CC's decision was a complex one. No SLC was found in their main fertilizer businesses, but the CC did expect an SLC to emerge in the sale of CO₂ and certain nitrogen-based chemicals, as a result of the joint venture. Customers were partly captive, because of their location close to production facilities. Details of all of the calculations below are commercially confidential, and we have therefore not reported the estimated detriment for individual products or the components of the calculation.

For CO₂ the CC used two approaches to estimate the likely price rise post-merger. First, the CC assessed the impact of a production shutdown at the parties' main plant in the North-East of England. During this supply shortage prices increased to those customers without long-term contracts. Details are commercially confidential but the increase in prices per tonne was more than 100 per cent. Over a longer period there could be an increase in imports, sourced primarily through a facility owned by Yara at Purfleet. However, importing CO₂ through this facility would increase haulage costs considerably. The CC estimated that the cost of haulage from Yara would be approximately £15 per tonne. If passed on in the form of final prices this would result in a 41 per cent increase in effective prices to customers in Northern half of the UK. For nitric acid at 58 to 60 per cent concentration, the JV would have a UK monopoly but price rises might be constrained to 10 per cent by customers' ability to switch to imports. This figure was added to the total detriment estimate.

The CC also reached SLC findings for ammonia production relating only to those customers who had a choice of provider pre-JV. Imports were not cost-effective for aqueous ammonia, so we assume a 10 per cent price increase. Anhydrous ammonia is a hazardous chemical and more dangerous to transport, requiring specialist ships and facilities, we therefore assume that a slightly higher price increase of 15 per cent could be sustained post merger.

In total, these sum to around £6.1 million annually.

Macquarie/National Grid

This was a merger involving the two main providers of masts for radio and television, which also provided some services for mobile telephony. The CC permitted the merger to proceed subject to accepting undertakings, partly because it believed that there were substantial cost savings to be gained from the merger and that, with appropriate undertakings, these could be passed to consumers. One unusual feature of the case was the very long timescales considered. Customers only very infrequently negotiate contracts, which might then last for 30 years. Much of the analysis of customer benefits, to be set against detriments arising from the loss of competition, was therefore conducted in NPV terms. Following the case, the case team built upon this analysis to estimate the detriment avoided by the CC's decision as follows:

- All of the benefit of guaranteed discounts to customers which are part of the undertakings (£78.4 million NPV 2008–2020).

- All of the merger synergies which are being passed back to customers as part of the undertakings (it is possible that some of these savings might have been passed back anyway, but this was not guaranteed, particularly in the absence of the competition that would have been provided were it not for the merger) (£86.1 million NPV 2008–2020).
- In addition, there is some financial merit to the array of other behavioural remedies, not least the contract right renewal measure, and the imposition of a regulator to ensure cost-oriented terms. This is harder to quantify. Arqiva and NGW together generate about £400 million annual revenues from their combined broadcast services and wireless business. If, in the absence of the non-discount behavioural undertakings, Arqiva/NGW would have been able to increase prices by 5 per cent a year to that half of the market affected by the merger, the detriment would be £10 million a year.

The first two points result in a total NPV benefit of £165 million to 2020, equivalent to a steady annual flow of £18.8 million, using a real discount rate of 7.4 per cent. The combined annual detriment avoided by the CC's decision is therefore of the order of £30 million.

BSkyB/ITV

We note again that at the time of publication, the CC's decision on BSkyB/ITV was being considered by the Competition Appeals Tribunal, following applications for judicial review by BSkyB and by Virgin. The assessment should therefore be regarded as provisional.

This merger decision involved BSkyB taking an ownership stake in ITV. Following the report, the case team estimated an annual detriment of around £240 million which would result from:

- (a) Lower quality of FTA programming and innovation, quantified as a 3 per cent decrease in ITV's expenditure on programming (£30 million detriment).
- (b) Increased pay-TV prices and lower quality and innovation in pay-TV services, quantified as a 3 per cent increase in the price of pay-TV services (around £210 million detriment).

Although for reporting purposes this is a point estimate, it should not be regarded as conveying more than an estimate that the detriment is in the hundreds of millions of pounds.

Given the absolute size of the markets involved, small differences in the percentage figures adopted for these calculations result in very significant changes to the size of the detriment estimated. As an example using 2 and 4 per cent leads to a total annual detriment of, respectively, around £160 million and £330 million. Using, as is typically done, a figure of 5 million would lead to an estimate of over £400 million. In this case it would be appropriate to build some caution in the figures.

This is to reflect some aspects of the competitive process taking place in the all-TV relevant market as well as to recognize that the strategies leading to an SLC would be different because the acquiring firm has not obtained full control of the target company in this case. Both these issues complicate the way in which the SLC would lead to a customer detriment.

Market investigations

NI Banks

This market investigation reported a range of £12–24 million for the annual consumer detriment it found. Details of the calculations are provided in the report, at Table 13.⁹

⁹http://www.competition-commission.org.uk/rep_pub/reports/2007/fulltext/527.pdf at page 180.