

**British United Provident Association Limited
and Community Hospitals Group plc:**

a report on the proposed merger; and

**British United Provident Association Limited,
Salomon International LLC and
Community Hospitals Group plc;**

and **Salomon International LLC
and Community Hospitals Group plc:**

a report on the existing mergers



COMPETITION COMMISSION

British United Provident Association Limited and Community Hospitals Group plc

A report on the proposed merger

British United Provident Association Limited, Salomon International LLC and Community Hospitals Group plc; and Salomon International LLC and Community Hospitals Group plc

A report on the existing mergers

**Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty
December 2000**

© Competition Commission 2000

***Web site:* www.Competition-Commission.org.uk**

Members of the Competition Commission as at 8 November 2000

Dr D J Morris (*Chairman*)
Mrs D P B Kingsmill CBE (*Deputy Chairman*)
Mr H G C Aldous
Professor J Beatson QC
Mr R D D Bertram
Mrs S E Brown
Professor M Cave
Mr A T Clothier
Mr R H F Croft CB
Mr C Darke
Mr N Garthwaite
Professor P A Geroski
Professor C Graham
Mr G H Hadley
Mr D B Hammond
Miss J C Hanratty
Mr C E Henderson CB
Mr D J Jenkins MBE
Mr R Lyons
Mr P Mackay CB
Dr E M Monck
Miss K M H Mortimer¹
Mr R J Munson
Professor D M G Newbery
Dr G F Owen
Professor D Parker
Mr A J Pryor CB¹
Mr R A Rawlinson
Professor J A Rees¹
Mr T S Richmond MBE
Mr J B K Rickford
Mr E J Seddon
Dame Helena Shovelton DBE
Mr G H Stacy CBE
Mr J D S Stark
Professor A Steele
Mr M R Webster
Mr A M Young

Miss P A Boys (*Secretary*)

¹These members formed the Group which was responsible for this report under the Chairmanship of Professor J A Rees.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests.

The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

Contents

	<i>Page</i>
Part I—Summary and Conclusions	
<i>Chapter</i> 1	Summary..... 3
2	Conclusions 5
Part II—Background and evidence	
3	The merger situations and the companies involved 49
4	The relevant markets and the effects of the proposed merger 77
5	The views of the main parties 119
6	Views of third parties 147
	List of signatories 182
<i>Appendices</i>	(The numbering of the appendices indicates the chapters to which they relate.)
1.1	The reference and background 183
3.1	Chronology 185
3.2	Structure of Salomon Smith Barney companies as at 1 May 2000 186
3.3	BUPA group structure as at 23 June 2000 187
3.4	Summary of BUPA’s group structure, 30 October 2000 188
3.5	BUPA’s proposed group structure 189
3.6	BUPA group: forecast post-restructuring balance sheet 190
3.7	Regulation of insurance companies and private hospitals 191
3.8	BUPA: consolidated balance sheets as at 31 December 1999 194
3.9	BUPA: analysis of financial investments and debt structure, 1995 to 1999 195
3.10	BUPA: consolidated income and expenditure account, 1995 to 1999 196
3.11	BUPA: consolidated cash-flow statements, 1995 to 1999 197
3.12	CHG: consolidated balance sheets, 1995 to 1999 198
3.13	CHG: consolidated profit and loss accounts, 1995 to 2000 199
3.14	CHG: consolidated cash-flow statements, 1995 to 2000 200
3.15	BUPA: discounted cash-flow model 6 per cent revenue growth, no savings, 1998 to 2005 201
3.16	BUPA: discounted cash-flow model 6 per cent revenue growth, with savings, 1998 to 2005 202
4.1	Relevant reports on UK private healthcare markets 203
4.2	OFT Press Notice (PN 40/99, 5 November 1999) 204
4.3	An extract from <i>The NHS Plan</i> , Cm 4818–I, July 2000 206
4.4	Areas of significant overlap identified by BUPA/OFT 209
4.5	Local market analysis 210
5.1	BUPA Confidentiality Policy and Guidelines 212
5.2	BUPA’s Partnership Network eligibility criteria 229
	Glossary 234

Part I

Summary and Conclusions

1 Summary

1.1. On 12 June 2000 the Secretary of State for Trade and Industry referred to us for investigation under the Fair Trading Act 1973 (the Act) the proposed acquisition by British United Provident Association Limited (BUPA) of Community Hospitals Group plc (CHG). On 8 August 2000 the Secretary of State also referred to us for investigation under the Act the acquisition by Salomon International LLC (SIL) of 26.8 per cent of the ordinary share capital of CHG. Our report deals with both references. Our terms of reference are set out in Appendix 1.1.

1.2. BUPA is the largest provider of private medical insurance (PMI) and the second largest provider of private medical services (PMS) in the UK. CHG is the fourth largest PMS provider (measured by bed capacity) but has no PMI interests. SIL is a wholly-owned subsidiary of Citigroup Inc, of New York, and owns [26.8] per cent of Salomon Brothers UK Equity Limited (SBUKE).

1.3. In 1997 BUPA sought to acquire Goldsbrough Health Care plc (Goldsbrough). This merger was approved by the Secretary of State, subject to BUPA undertaking to divest Goldsbrough's shareholding in Independent British Health Care Limited (IBH) and not in the future acquire any interest in IBH or any interest in any company having control of IBH. In 1998 CHG acquired IBH.

1.4. On 28 April 2000 the boards of BUPA and CHG announced that they had reached agreement on the terms of a recommended cash offer for the entire share capital of CHG. BUPA had learned that there were potential rival bidders, but it could not itself buy any CHG shares while the 1997 undertaking remained in force. BUPA therefore decided to take pre-emptive action through a third party. On 5 May 2000, under an agreement with BUPA Finance Plc (BUPA Finance, a subsidiary of BUPA), SBUKE acquired 26.8 per cent of the ordinary shares of CHG at a cost of £61.75 million, met wholly by a loan from BUPA Finance. Ownership and complete control of these shares was vested in SBUKE. BUPA carried all the economic risk. Neither SIL nor SBUKE had any other PMS interests: the share purchase was intended solely to assist BUPA achieve its object of securing control of CHG when the undertaking was lifted. We considered that BUPA and SBUKE must each have an expectation that SBUKE would retain the shares until the competition authorities had reached their conclusions and that must have been the commercial reality of the matter.

1.5. We found that SBUKE's acquisition of 26.8 per cent of CHG's shares gave it influence over CHG's policy that should be treated as control for the purposes of the Act and that this created an existing merger situation between SIL and CHG. We also found that the circumstances of the loan agreement and the resulting share purchase were such that BUPA and SBUKE were associated persons for the purposes of the Act and that this created an existing merger situation involving BUPA, SIL and CHG. We considered these two merger situations separately from the proposed BUPA/CHG merger situation.

1.6. The latter situation had been referred to us because the Secretary of State agreed with the Director General of Fair Trading (DGFT) that the proposed merger raised competition concerns in respect of both the PMS and PMI markets. We received submissions from 12 PMS and

8 PMI providers. All of the former, and all but one of the latter, were hostile to the proposed merger in varying degree, urging either its prohibition or the imposition of a variety of constraints if it were approved. The concerns expressed related in part to the consequences for local competition but chiefly to the reinforcement that the proposed merger would give to BUPA's seller power in the PMS market and the vertical linkages between its PMS and PMI businesses.

1.7. BUPA said that competition should be looked at in terms of local markets and suggested that any problems could be dealt with by divestments. We conducted our own analysis of local markets and identified some areas where competition would be adversely affected. However, we found that the much more important adverse effects of the proposed merger would be a reduction of competition in the PMS market and higher prices for PMI and PMS than would otherwise have been the case, and hence that the proposed merger would be adverse to the public interest.

1.8. BUPA told us of its care to ensure the integrity of the separation of PMI and PMS functions and said that it proposed to take various measures to separate its PMI and PMS businesses still further, while retaining both within its ownership and control. We considered these arrangements carefully but in the light of our finding we concluded that nothing short of putting the businesses under separate ownership and control would meet the case satisfactorily. However, BUPA told us that it would not proceed with the merger on that basis.

1.9. We concluded, therefore, that the right course was to recommend that the proposed BUPA/CHG merger be prohibited.

1.10. We then turned to the existing SIL/CHG and SIL/CHG/BUPA merger situations. We concluded that these situations could be expected to be adverse to the public interest because the circumstances of BUPA's involvement in SBUKE's acquisition of the CHG shareholding, in particular the terms of the loan agreement, were widely known (from the terms of BUPA's offer of 24 May for all CHG's shares). These circumstances were such as to make SBUKE's retention of the CHG shareholding a cause of concern and uncertainty, lasting for perhaps 12 months or more, to many parties involved with CHG. BUPA would be seen by them as exercising material influence over CHG. The resulting uncertainty would be damaging to CHG's management, employees and contractors and to patients, consultants and PMI providers. Other prospective bidders for CHG would also be deterred to the detriment of a normal competitive market in CHG shares.

1.11. Accordingly, we recommend:

- (a) that SBUKE put proposals to the DGFT to reduce its CHG shareholding as soon as market circumstances are favourable and with a view in any event to complete disposal within six months from the date of publication of this report, or within such time as the DGFT thinks fit; and
- (b) that for as long as SBUKE holds CHG shares it should be prohibited from exercising its rights to vote on any matter without the consent of the DGFT.