

Estimated costs to consumers of mergers and market outcomes against which the CC took action between April 2008 and March 2009

1. 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 its decisions. This note summarizes the derivation of the estimates of these costs for the five mergers against which the CC took action, the two market investigations and the two regulatory investigations on which the CC reported between April 2008 and March 2009.¹
2. 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 seeks to quantify only 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). 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.
3. This is the fourth year that the CC has produced an estimate of customer detriments in this way. This year the CC has changed the way in which it aggregates and reports these detriments in order to achieve consistency with the methodology used by the Office of Fair Trading (OFT).

Our approach

4. In making this estimate of consumer detriment, we recognize that our approach is partial in scope and subject to considerable uncertainties in its application.
5. 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 anti-competitive 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.
6. 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, a percentage of the total turnover of the sectors examined. Our approach to estimation is more complex, but the same basic

¹The CC took action against two of these mergers (Stonegate/Deans and Tesco/Co-op Slough) before the current year. However, their detriment estimates have only been calculated this year.

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. 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.

7. 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.
8. 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 understate 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).
9. The CC completed two **regulatory investigations** in 2008/09, one relating to the Civil Aviation Authority's (CAA's) proposed price controls for Stansted Airport. The other was the CC's determination on the price control matters in appeals brought against Ofcom by Hutchison 3G and British Telecom in relation to the control of mobile phone wholesale termination charges, referred by the Competition Appeal Tribunal (CAT). 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 2008/09.**

One system with two authorities

10. 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.² For mergers, customer detriment is avoided when the CC remedies a substantial

²In the case of market investigations, sectoral regulators also have the power to make references to the CC. The market investigations considered in this document resulted in references to the CC by the OFT.

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 market investigations, 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.

11. We therefore present a combined figure for the work of the OFT and the 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.

Summary of findings

12. The CC reached SLC findings in five merger inquiries under the Enterprise Act 2002. In addition, it reached a finding of 'adverse effects on competition' in two market investigations. All the reports are available on the CC website.
13. 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.
14. 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 £29 million a year, made up as follows⁴:

<i>Merger inquiry</i>	<i>Estimated detriment to consumers a year £m</i>
BOC/Ineos	0.7
NuFarm/AH Marks	2
Project 'Kangaroo'	2
Stonegate/Deans	24
Tesco/Co-op Slough	0.4

15. The CC has changed the way it combines these yearly estimates so as to use the same methodology as the OFT. Accordingly, the CC converted these yearly detriment estimates to net present values (NPVs) over two years.⁵ The total of the NPVs of the detriment avoided from these five merger decisions is then averaged with the corres-

³Available, annually, at www.of.gov.uk/advice_and_resources/resource_base/evaluation/publications.

⁴Here and in what follows, we round estimates to the nearest million, unless the estimate is below £1 million, where we round to the nearest £100,000.

⁵This NPV calculation involved using the Social Discount Rate of 3.5 per cent, see the Treasury Green Book 'Appraisal and Evaluation in Central Government', Chapter 5. <http://greenbook.treasury.gov.uk/chapter05.htm>.

ponding figures⁶ from 2006/07 and 2007/08. This procedure puts the 2008/09 total detriment avoided as a result of CC merger decisions at £199 million.

16. 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 £114 million⁷ in 2008/09, so total detriment to consumers avoided as a result of the merger regime was £313 million.
17. The CC completed **two market investigations** under the Enterprise Act: Payment Protection Insurance (PPI) and BAA Airports. The estimated costs to consumers avoided as a result of the PPI investigation decision was estimated at a lower bound of £278 million annually (this related to one element of the net consumer detriment that the CC had been able to quantify, although the total consumer detriment avoided as a result of the remedies would be substantially greater than this). A lower bound for the estimated costs to consumers avoided as a result of the BAA Airports investigation decision was estimated, for only a very limited part of the adverse effects on competition addressed, at £4 million annually. As with the merger detriment estimates, we converted these into NPVs⁸ and averaged over 2008/09, 2007/08 and 2006/07.⁹ This procedure puts the 2008/09 total detriment avoided as a result of CC market investigations at £270 million.
18. For mergers and markets combined, we therefore estimate total consumer detriments avoided as a result of the CC's and OFT's work at **£608 million**.¹⁰
19. *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 £403 million.*

Summaries of cases

20. We provide below short summaries of how the avoided customer detriment was calculated in each of the cases cited here. 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,¹¹ remain the authoritative statement of the CC's findings.

⁶In order to get comparable figures for 2006/07 and 2007/08 we had to convert the annual detriment from mergers in each year into an NPV over two years. We also adjusted for inflation so that previous years' estimates are in 2009 prices.

⁷As with the CC's figure, this is an average of two-year NPVs for all mergers over 2008/09, 2007/08 and 2006/07.

⁸For PPI, we calculated the NPV over two years using the 3.5 per cent Social Discount Rate, as we did for the merger estimates. However, the Airports report contained an estimate of the NPV of the detriment avoided using a different time frame and discount factor, and so we used this estimate.

⁹As before, this involved converting annual estimates from previous years into NPVs.

¹⁰This includes £25 million from the estimated average benefit from the OFT's review of SME banking.

¹¹www.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'.

21. 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

BOC/INEOS

22. This was a proposed acquisition by BOC of the chlorine packaging and distribution business and assets of Ineos Chlor. The principal use of packaged chlorine is by the UK water industry for water disinfection. The CC concluded that the merger would result in an SLC in the markets for the distribution of packaged chlorine in cylinders and in drums in the UK.
23. Considering the constraint exerted by imported packaged chlorine in cylinders and drums, the CC believed that the merged entity would be able to raise prices by [0 to 10] per cent in the cylinder distribution market and by [20 to 30] per cent in the drum distribution market. The CC considered that demand was relatively inelastic in these markets and so import prices would be the binding constraint on the merging parties. This equates to a total estimated UK detriment of £0.7 million a year.

Nufarm/AH Marks

24. Nufarm is a manufacturer and worldwide supplier of generic crop protection products based in Australia with plants also in the UK, Austria and the Netherlands. Nufarm manufactures and sells a variety of herbicides, insecticides, fungicides and other related products. AH Marks was previously an independent UK manufacturer and exporter of chemical products. The CC concluded that the merger could damage competition in the market for the supply of two phenoxy acids, namely MCPA at the technical acid, manufacturing concentrate and formulated product levels of the supply chain and MCPP-p at the manufacturing concentrate and formulated product levels of the supply chain.
25. The CC found that for MCPA-based products the merged entity would be able to raise prices by [10 to 60] per cent, and for MCPP-p-based products by [20 to 50] per cent. These estimates were based on customer estimates of the price increase that would induce them to switch to products with other bases. These ranges of post-merger price increases gave a range of estimated detriment figures, the lower bound of which was £2 million annually.

Project 'Kangaroo'

26. Project 'Kangaroo' was a 'video-on-demand' (VOD) joint venture between BBC Worldwide Limited, Channel 4 and ITV. VOD is a service allowing viewers to select and watch programmes or films when they want to, from a range of alternative content, available on a variety of platforms, including cable and satellite television and online. The CC concluded that the joint venture would lead to a loss of rivalry, amounting to an SLC in the supply of UK television VOD content at the wholesale and retail levels. The

final report stated that it would be an inherently difficult exercise in this developing market to quantify the detriment associated with the SLC and it did not attempt to do so.

27. As an indication we therefore adopted an estimate of [0 to 5] per cent of the total VOD retail turnover. To calculate this, we used estimates of turnover from retail VOD as submitted by the parties in their Joint Position Paper on Competitive Effects. We note that these estimates included retail revenue from both UK and non-UK VOD and are therefore likely to overestimate the transactional retail VOD revenues from UK television VOD. Nevertheless using this arbitrary approach provides an indicative estimate of the consumer detriment of £2 million in 2009.

Stonegate/Deans

28. This was an investigation into the merger of Stonegate and Deans, the two largest suppliers of shell eggs to retailers in the UK. The CC found that this merger would result in an SLC in the market for the supply of shell eggs to retailers and an SLC in the market for the procurement of shell eggs from producers.
29. In the market for the supply of shell eggs to retailers, the CC concluded that the merger would result in increased prices to both customers of the merging parties and to customers of the remaining competitors. The CC considered the price at which imports would become a constraint on post-merger prices. Given this, the CC then made a conservative assumption that customers would face an average price rise of [0 to 10] per cent following the merger. This resulted in an estimated annual consumer detriment in the downstream market of approximately £20 million based on 2005 data.
30. In the market for the procurement of shell eggs from producers, the CC was unable to establish the precise magnitude of the supply restriction that would result from the merged entity's increased monopsony power. As a result, a conservative estimate of [0 to 5] per cent of the procurement market turnover was taken as a guide to the detriment. This gives an annual consumer detriment in the upstream market of approximately £4 million based on 2005 data. Combining the two detriment estimates gives an overall annual detriment estimate of £24 million.

Tesco/Co-op Slough

31. This was an inquiry into the acquisition by Tesco of a Co-op store in Slough. The CC concluded that the merger resulted in an SLC in the market for grocery retailing in Slough, as well as reduced choice in grocery retailing for Slough residents.
32. The CC estimated that this SLC would translate into a profit increase of between £380,000 and £443,000 a year at the expense of consumers. Taking the mid-point of these two estimates gives an estimated consumer detriment from this merger of £0.4 million a year.

Markets

BAA Airports

33. The CC conducted an investigation into the supply of airport services by BAA. The CC found adverse effects on competition from BAA's common ownership of airports in the

South-East and Scotland, and required divestment of Gatwick, Stansted and one of Edinburgh and Glasgow. The CC also found that Aberdeen and Heathrow airports had unilateral market power and the CC imposed behavioural remedies on BAA in regard to these two airports.

34. The CC estimated a lower bound on the consumer detriment as a result of BAA's common ownership of Edinburgh and Glasgow airports of between £4 and £7 million a year, or an NPV of £40–£70 million over 30 years. This was on the assumption that, in the absence of common ownership, price reductions at Edinburgh following the earlier sale of Prestwick Airport by BAA would have been at least as great as price reductions at Glasgow.
35. The CC did not find it possible to quantify the detriment to consumers as a result of BAA's common ownership of the London airports due to more complex interactions and the existing regulatory regime. The estimate of the NPV of the consumer detriment of £40 million in relation to the common ownership of Edinburgh and Glasgow airports is therefore a lower bound to the estimated consumer detriment of only a very limited part of the AEC identified.

PPI

36. The CC conducted a market investigation into the supply of PPI. The CC identified three categories of consumer detriment. The first was a dynamic consumer detriment as a result of the effects over time of an uncompetitive market. The CC expected this detriment to be very large, but was unable to put a value on it. Similarly the CC identified a further detriment, which it could not quantify, as a result of the effect of high prices for PPI on claims costs through adverse selection.
37. Finally, the CC assessed the static consumer detriment as a result of the distortions in prices in the markets for PPI and credit. The extent of this detriment is affected by the scale of so-called waterbed effects, where some or all of the profits made on PPI are competed away in the form of low credit prices. Using the most conservative assumption of a full waterbed effect, where distributors make no profits overall, then the 'static' detriment to consumers of personal loans, first-charge mortgages and second-charge mortgages was around £200 million a year. Using similar assumptions, the CC estimated a static impact on credit card customers of £66 million. The CC estimated that the static consumer detriment for customers of retail PPI, for which there was no waterbed effect, was £12 million.
38. Because it was unable to quantify a substantial part of the consumer detriment, and because the precise scale of waterbed effects was unclear, the CC is able to supply only a lower bound for the consumer detriment in PPI. These figures will greatly underestimate the detriment that would have been incurred by PPI consumers were it not for CC action. This lower bound is estimated to £278 million annually.

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