

Estimated benefits to consumers from the CC's actions in mergers and market investigations between April 2009 and March 2010

1. The Competition Commission (CC) seeks to evaluate its effectiveness in a number of ways, including quantification of the benefits¹ that are expected to flow to consumers as a result of the CC's decisions. This note summarizes the derivation of the estimates of these benefits for the merger against which the CC took action, and the two market investigations on which the CC reported between April 2009 and March 2010. It also comments on the consideration the CC gave to estimating the benefits of the CC's determination in the regulatory investigation the CC completed in 2009/10.
2. Where the CC finds a substantial lessening of competition (SLC) in a merger inquiry or an adverse effect on competition (AEC) in a market investigation—for example, when a merger leads to a reduction in rivalry, such that consumers are expected to pay higher prices or receive lower quality than they would otherwise have done—it takes action or makes recommendations to others to take action to remedy the SLC or AEC and/or the resulting harm to consumers.
3. In previous years the CC has sought to quantify only the detriment, not the likely impact of its remedial action.
4. This year the CC has revised this methodology to take account of the likely impact of its remedies and hence quantified the benefits it expects to flow to consumers rather than just the detriment that has been identified as resulting from the SLC or AEC.² This revised methodology will be applied in future years.
5. For mergers, the CC would normally expect its remedies to result in the avoidance of all of the consumer detriment resulting from an SLC. In anticipated mergers, the CC has the option of prohibiting the transaction, which would be fully effective in remedying the SLC. For completed mergers also the CC will generally decide upon a divestiture (which may be of the acquired business or a partial divestment) which would similarly be fully effective. The CC will not generally impose an alternative remedy (such as a behavioural remedy) unless this is expected to be broadly as effective as a prohibition or full divestiture, and hence capable of avoiding all the consumer detriment resulting from an SLC.³
6. For market investigations, the CC will also generally seek, when deciding upon appropriate remedies, to remedy fully the AEC it has found and may also choose remedies that address any customer detriments it has identified. However, the remedies may sometimes be partially rather than fully effective and the timescales in which the remedy becomes effective will vary. The CC seeks to reflect its views on the likely magnitude and timescale of the impact of market investigation remedies in its estimates of benefits to consumers from its actions in specific market investigations.

¹Benefits generally refer to net benefits from the CC's actions; in some cases, however, small implementation costs may not be included.

²The CC seeks to assess the effectiveness of its remedies periodically, by looking back at past cases. Such evaluations can be found on this web page: www.competition-commission.org.uk/our_role/analysis/evaluation_reports.htm.

³In general, one or more of the following conditions will normally apply in the unusual circumstances where the CC selects behavioural remedies as the primary source of remedial action in a merger inquiry: (a) divestiture and/or prohibition is not feasible or the relevant costs of any feasible structural remedy far exceed the scale of the adverse effects of the SLC; (b) the SLC is expected to have a relatively short duration (eg two to three years) due, for example, to the limited remaining term of a patent or exclusive contract; and (c) relevant customer benefits are likely to be substantial compared with the adverse effects of the merger and these benefits would be largely preserved by behavioural remedies but not by structural remedies. *Merger Remedies: Competition Commission Guidelines*, November 2008 (CC8), [paragraph 2.16](#).

Our approach

7. Estimating consumer benefits is subject to considerable uncertainties in its application. In all cases the CC attempts to take this uncertainty into account and provide what it believes to be a conservative figure. Further, for the reason explained below, the estimation is partial in scope.
8. In particular, it estimates the value only of CC remedy decisions in cases where it finds an SLC or AEC. Clearance decisions of merger and market investigations will also provide economic benefits to consumers and to the economy generally. Such benefits are harder to identify and estimate (for example, merger-specific benefits such as cost savings and general benefits arising from the existence of an active capital market that are not specific to a given merger). These benefits are not included in the CC's estimation. Additionally, the CC does not include estimations of mergers that would produce anti-competitive effects but which do not proceed, as a result of the deterrent effect of the existence and enforcement of the UK merger regime. Furthermore, the CC recognizes that introducing competition into markets can generate dynamic benefits—such as product and process innovation and allocative efficiencies—which are generally difficult to quantify and hence are not always included in our calculations of detriment, but which are nonetheless an important beneficial effect of our interventions. The total value reported here is therefore a very partial measure of the value of the competition regime, which happens to be easier to calculate than these wider measures.
9. The scale of the sectors within which detriments arise will have a strong influence on the estimated benefit from the CC's actions. Some authorities recognize this explicitly by taking, for example, annual merger detriment to be a percentage 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. The CC does not determine which sectors are referred to it, and consequently cannot prioritize potentially more beneficial inquiries over others. Any estimate of consumer benefits from its decisions is likely to be variable from year to year. In order to present figures that are not overly influenced by such fluctuations the CC reports estimates as three-year averages,⁴ as discussed further in paragraph 20.
10. 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.
11. The remedies that the CC implements deliver benefits to consumers over time. In order to capture this, the CC presents the net present value (NPV) of the annual benefits it estimates. The CC considers presenting an NPV over two years to be conservative and adopts this approach unless the facts of a particular case suggest it is better to use an alternative time frame.
12. For **mergers**, the CC seeks to identify the likely price rises or other consumer detriment that would have arisen had it 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. The estimates presented in this note represent a 'best guess' derived from all the information available to the CC for each case. The CC does not

⁴This year's figures are averages of 'benefits' (for those cases reported in 2009/10) and 'detriments' (for those cases reported in the previous two years). However, only one market investigation case is reported as a detriment and the CC considers any discrepancy to be small.

adopt a single methodology in each case; rather it seeks to capture what the team conducting that investigation believed was the likely effect of the merger.

13. 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, and hence of the potential benefits arising from the CC's remedial action, typically relate to past years. In some cases, it is possible that problems might to some extent be self-correcting, so that this might overestimate the likely future benefits of the CC's remedies. Equally, however, in some cases the detriment might be increasing and this backward-looking estimate will understate the future benefits from the CC's decisions. As with mergers, the methodology in each case is highly specific to that case (and, unlike mergers, usually forms a part of the CC's investigation at the time and, if so, is set out in the published report).
14. The CC completed one **regulatory investigation** in 2009/10, relating to the Water Services Regulation Authority's (OFWAT's) determination on Sutton and East Surrey Water's application to increase its price limits in April 2009. The CC's role in this case was to determine the price limits, the parties—ie OFWAT and Sutton and East Surrey Water—being in disagreement. The CC considered whether it was possible to estimate the value of its determination and whether to include the estimated detriment for this case, or some other measure of its effectiveness. However, the CC has not yet been able to identify a means of quantifying the benefits of its decision, **and accordingly has not estimated any value arising from its regulatory decision in 2009/10**. However, in subsequent years the CC may consider a methodology for quantifying the benefits from the CC's actions in regulatory investigations.
15. The CC's decisions are subject to review by the Competition Appeal Tribunal (CAT). In merger inquiries and market investigations there is a window of four weeks and two months respectively following the publication of our final report, during which time any party with a sufficient interest in the CC's decision may launch an appeal against the CC's findings. In estimating the benefits of its actions for 2009/2010 the CC did not include benefits from any decisions in references for which the period to review its decision had not expired, nor for references which were subject to legal challenge.⁵ This is consistent with the way in which the Office of Fair Trading (OFT) presents its estimates of consumer benefits.
16. The CC's remedies can involve recommendations to other bodies that may or may not then be implemented. Where the CC makes such a recommendation, it assumes that it will be fully implemented by the other body in question and includes all of the estimated consumer benefits from this remedy in its estimates of the consumer benefits from the CC's remedial actions.

The CC as part of the UK competition regime

17. 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.⁶ For mergers, benefits are generated when the CC remedies an SLC, but also if the OFT is able to avoid a reference because the merging parties can offer acceptable undertakings preventing an SLC arising, or if the merger is abandoned.

⁵Hence, estimated benefits from our market investigations into Payment Protection Insurance and BAA Airports have not been included in rolling average figures.

⁶In the case of market investigations, sectoral regulators also have the power to make references to the CC. The Groceries market investigation considered in this document resulted from a reference from the OFT, while the Rolling Stock Leasing market investigation resulted from a reference from the Office of Rail Regulation.

For market investigations, the OFT (or the other sectoral regulator) 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.

18. The CC therefore presents a combined figure for the work of the competition regime in these shared activities, using the CC figures reported here and the OFT's estimates reported in its annual *Positive Impact*⁷ 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, the CC and the OFT 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.⁸ This roughly corresponds to the proportions of cost incurred when a merger is referred to the CC, with the same proportions used for other activities for simplicity.

Summary of findings

19. In 2009/10 the CC reached an SLC finding in one merger inquiry under the Enterprise Act 2002. In addition, it reported on two market investigations. All the reports are available on the CC website.⁹ The estimated benefits are summarized in paragraphs 18 to 22. Further details are set out in paragraphs 25 to 33.
20. The CC found an SLC in relation to the **merger** between Capita and IBS and estimates that its remedies in this merger inquiry resulted in benefits to consumers in the order of £0.5 million a year.¹⁰ The CC converted this yearly benefit estimate to an NPV over two years and here presents a three-year rolling average of consumer benefits from its remedies for merger inquiries that resulted in an SLC decision between 2007/08, 2008/09 and 2009/10, as explained in paragraph 9.¹¹ This puts the 2009/10 total benefit from CC merger decisions at £205 million. This 2009/10 rolling average figure includes benefits from merger inquiries completed in the previous two years, and for this reason it is higher than the estimate of consumer benefits from the CC's decision from the single merger investigation in which it found an SLC in 2009/10.
21. The CC and the OFT together operate a single system of merger control. The OFT has estimated savings from undertakings in lieu of a CC reference and cancelled mergers of £106 million¹² in 2009/10, so total detriment to consumers avoided as a result of the merger regime was £310 million.¹³
22. The CC completed two **market investigations** under the Enterprise Act 2002: the Groceries market investigation¹⁴ and the Rolling Stock Leasing (ROSCOs) market investigation. The benefits to consumers as a result of the CC's ROSCOs investi-

⁷Available, annually, at www.of.gov.uk/OFTwork/publications/publication-categories/reports/Evaluating/.

⁸This 80:20 split applies to mergers and those market investigations referred by the OFT. However, for market investigations referred by other sectoral regulators the CC claims all of the benefits we estimate to arise from any remedies we impose.

⁹www.competition-commission.org.uk/.

¹⁰Here 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.

¹¹In order to get comparable figures for 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.

¹²As with the CC's figure, this is an average of two-year NPVs for all mergers over 2009/10, 2008/09 and 2007/08.

¹³Where figures appear not to sum this is because of rounding the figures to the nearest million when we report the figures—see footnote 7.

¹⁴Although the original Groceries investigation was concluded in 2008, the findings were subsequently successfully appealed in the CAT. The case was remitted to the CC, and we reported our revised findings in October 2009. These findings were not appealed and so we include the estimated consumer benefits as a result of our Groceries market investigation in the 2009/10 figures presented here.

gation decision were estimated at £2 million annually. This figure was converted into an NPV over two years. A lower bound for the estimated NPV of benefits to consumers as a result of the CC's Groceries market investigation decision was estimated at £800 million.¹⁵ As with the merger benefit estimates, we present a three-year rolling average of these NPVs¹⁶ putting the 2009/10 total consumer benefit as a result of CC actions in market investigations at £280 million. The OFT has estimated 2009/10 consumer benefits as a result of its actions in market studies at £37 million. This, combined with the CC's estimates of consumer benefits from its actions, puts the total 2009/10 estimate of consumer benefit from the authorities' actions in market investigations at £317 million.¹⁷

23. For mergers and market investigations combined, we therefore estimate total consumer benefits from the competition regime at **£627 million**.
24. We regard this joint figure as the most representative of activity, and any allocation between the authorities as somewhat arbitrary. However, were it necessary to allocate the figure above between the two bodies, then 80 per cent of its own merger and market decisions and 20 per cent of undertakings in lieu and cancelled mergers to the CC. This results in a total figure for the CC of £424 million.

Summaries of cases

25. Below are short summaries of how the consumer benefit was calculated in each of the cases cited here. The summaries set out below are not intended to be comprehensive accounts of the cases, but merely attempt to put the quantifications in context. The final reports, available on the CC website,¹⁸ remain the authoritative statement of the CC's findings.
26. 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 the CC needs to multiply a commercially confidential number by—for example—a percentage price rise. Because the product of this calculation is reported, the percentage rise also has to be excised in such cases, to preserve the confidentiality of these revenue figures.

Capita/IBS

27. The CC found an SLC in relation to the provision of revenue and benefits (R&B) software to new local authority customers and local authority customers on rollover contracts. The quantification of the detriment associated with this SLC is difficult. The variability of contracts across customers and the lack of price data at a sufficient level of disaggregation means that it is difficult to compare prices across different suppliers and hence predict an expected price rise had the merger taken place. Further the

¹⁵In this case the CC considered that it was appropriate to evaluate benefits from the remedies it imposed over a period of 25 years (see the final decision on the Groceries remittal, available on the Competition Commission's website: www.competition-commission.org.uk/inquiries/ref2009/groceries_remittal/final_decision.htm).

¹⁶As before, this involved converting annual estimates from previous years into NPVs.

¹⁷Note that the figure for the direct financial benefits to consumers from the market investigation regime is different from those presented as direct benefits for consumers from market studies and reviews in the OFT's *Positive Impact 2009/2010* publication. This is for two reasons. Firstly, the OFT's *Positive Impact 2009/2010* takes into account all of the OFT's market studies, including those where referral to the CC is not considered a possible option. Secondly, the CC's estimates also include references made not by the OFT but by sectoral regulators.

¹⁸www.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'.

final report states that the SLC may constitute price rises, reduced service levels and/or loss of innovation. The five- to seven-year duration of contracts also makes it difficult to estimate the annual revenue from the customers affected by the SLC identified.

28. Therefore as an illustration of the likely effect of the SLC the CC supposes that prices would have risen by [0–5] per cent following the merger, to all of the main parties' new customers of and customers on rolling contracts for R&B software. This gives an estimated consumer benefit as a result of this SLC decision of £0.5 million per year.

ROSCOs

29. The CC conducted an investigation into the leasing of rolling stock for passenger franchised services and the supply of related maintenance services. The CC found an AEC in the leasing of rolling stock for passenger franchised services but not in the supply of related maintenance services. The CC was unable to produce a robust estimate of detriment and so was unable to conclude whether the detriment was small or large. However, the CC identified two aspects to the adverse effects.
30. First, that in a substantial number of cases train operating companies (TOCs) did not have the potential to choose from a range of fleets that best suited their needs. There was no clear way of defining the number of relevant alternative rolling stock fleets a TOC would face in a well-functioning market.
31. Second, because of the lack of competitive pressures, ROSCOs had the opportunity to increase rentals above the competitive level that the CC would expect to find in a well-functioning market. The CC was aware that assessments of detriment based on analysis of past pricing and conduct may not have been a good indicator of levels of detriment in the future, especially given changing market conditions. It was also the CC's view that the ROSCOs did not appear to have taken full advantage of the opportunities to increase rentals. The estimate of this aspect of the adverse effects, based on a small assumed percentage reduction in lease rates and given that in some cases operators may have greater freedom to exercise choice and negotiate better deals, was £2–£60 million a year.
32. Given the highly uncertain range of detriment and taking a conservative assumption in relation to both the detriment and the extent of that detriment which our remedies would address, the CC estimates that its remedies would have an estimated benefit of between £2 million and £10 million a year. In the figures presented here, £2 million is used as the most conservative estimate of consumer benefits as a result of the CC's actions in this market investigation.

Groceries

33. The CC conducted a market investigation into the supply of groceries. The CC had concerns in two principal areas. First, several grocery retailers had strong positions in a number of local markets. Barriers to entry meant that consumers got a poorer retail offer in terms of prices, quality and service than would otherwise be the case, and grocery retailers with strong local market positions earned additional profits due to weak competition in those markets that amounted overall to an additional £105–£125 million in annual profits. The CC recommended to the Government and the devolved administrations that a competition test should be applied. The CC also acted to limit the ability of grocery retailers to restrict the use of land to prevent it from being used by their competitors. After the competition test was remitted to the CC by the CAT the CC calculated the NPV of the benefit of the competition test remedy to

consumers as £800–£2,800 million (corresponding to an annual benefit of £50–£125 million).

34. Second, the CC found that the transfer of excessive risk and unexpected costs by grocery retailers to their suppliers through various supply chain practices, if unchecked, would have an adverse effect on consumers by reducing investment and innovation in the supply chain. The CC introduced the Groceries Supply Code of Practice (the GSCOP) by order, to set minimum standards of practice in certain aspects of retailers' dealings with their grocery suppliers. The ten largest grocery retailers have had to incorporate the GSCOP into their supply agreements. The CC did not find it possible to quantify the magnitude of the detriment arising from the supply chain practices but noted that the annual sales of the groceries supply chain was approximately £70 billion and even a small loss in investment and innovation was likely to have a significant detrimental impact on consumers. The CC also recommended to the Government that it establish an Ombudsman to oversee the GSCOP and to help ensure its effectiveness.
35. The CC therefore presents £800 million as a lower bound of the NPV of consumer benefits resulting from the remedies to the Groceries market investigation.