Non-price effects of mergers*

Peter Wantoch,** Riccardo Ferrari,† Joel Bamford‡ and Maria João Duarte§

Abstract: The Competition and Markets Authority (‘CMA’) assesses both the price and the non-price effects of mergers. The relative importance of each depends on the process of rivalry between the merging firms and their competitors. Dynamic non-price effects, for instance on innovation, are potentially important, as the CMA found in the ICE/Trayport merger, which was prohibited. Non-price parameters such as quality, range and service are also important and are considered in particular when mergers occur in markets where price competition is limited, for example public services such as hospitals and regulated markets such as pharmacies.

Keywords: Merger control, Competition and Markets Authority, non-price effects, innovation, quality, range and service

1. Introduction

The CMA has responsibility for the review of mergers under the Enterprise Act 2002. Under the UK merger control rules, mergers qualify for review if they meet either of the following tests: (i) the UK turnover of the business to be acquired exceeds £70 million; or (ii) the merger creates or enhances a share of 25% or more in the supply or purchase of any goods or services in the UK, or in a substantial part of the UK. Due to the UK’s voluntary merger notification regime, mergers can complete before the conclusion of an investigation and the CMA can open merger investigations on its own initiative. The CMA has a duty to refer a merger for a second in-depth (Phase 2) investigation where it believes there to be a realistic prospect that the merger will result in a substantial lessening of competition (‘SLC’) in a market in the UK. The CMA also applies the SLC test in its Phase 2 decision-making but decisions are based on a balance of probabilities and are made by a panel of independent members. The CMA’s Phase 2 investigation may lead to a clearance, a prohibition or a decision that the merger should be allowed to proceed subject to commitments. The SLC test is applied in the UK in a broadly similar way to the ‘significant impediment of effective competition’ test used by the European Commission.

The CMA’s approach to assessing whether a merger results in an SLC is set out in its Merger Assessment Guidelines,¹ which state that:

A merger gives rise to an SLC when it has a significant effect on rivalry over time, and therefore on the competitive pressure on firms to improve their offer to customers or become more efficient or innovative. A merger that gives rise to an SLC will be expected to lead to an adverse effect for customers. Evidence on likely adverse effects will therefore play a key role in assessing mergers.²

In assessing mergers, the CMA will generally consider both evidence relating directly to the loss of rivalry and evidence relating to the likely effects of the merger. With regard to evidence on likely effects, the CMA will consider both price and non-price effects (‘NPEs’), depending on the circumstances of the merger concerned and the markets affected.

As outlined in the OECD’s call for contributions it is useful in considering NPEs to distinguish between static effects, reflecting short run decisions by the firms concerned, for example on quality, and dynamic effects, reflecting longer run decisions on investment and innovation. This article sets out the CMA’s practical experience of investigating mergers with both static and dynamic NPEs.

* This article is based upon a submission made by the Competition and Markets Authority to a best practice roundtable organized by the Competition Committee of the Organisation for Economic Co-operation and Development held on 6 June 2018, full details of which are available at: http://www.oecd.org/daf/competition/non-price-effects-of-mergers.htm.
It has not been updated to take account of subsequent developments.

** Assistant Director of Economics, Competition and Markets Authority.
† Economic Adviser, Competition and Markets Authority.
‡ Senior Director of Mergers, Competition and Markets Authority.
§ Deputy Director, Mergers, Competition and Markets Authority.
² Merger Assessment Guidelines (in 1), para 4.1.3.
2. The importance of non-price effects in merger reviews

The NPEs that the CMA considers in a merger case will depend on the theories of harm about how rivalry is affected by that merger. The CMA’s Merger Assessment Guidelines refer to quantity sold, service quality, product range, product quality and innovation. The extent to which each of these are assessed in an individual case will depend on the aspects of the merging firms’ competitive offers to customers over which the firms compete, and which could worsen as a result of the merger.

2.1. Dynamic NPEs

Dynamic NPEs are most likely to be considered where product and/or process innovation are important to the merging parties’ competitive offering and when the merger occurs at the level at which decisions on investment and innovation are made. Dynamic effects have been considered in recent CMA merger inquiries, for example:

- In Intercontinental Exchange/Trayport (which concerned two companies involved in the financial trading of energy derivatives), the CMA placed particular weight on the loss of dynamic competition (which takes place through the introduction of new products and innovative trading solutions), and which the CMA found was likely to harm traders because they would be offered a more limited range of trading opportunities and tools, although it also found static price and non-price effects. The CMA expected the merger to result in an SLC and prohibited the merger.

- In Just Eat/Hungryhouse, a merger of two food ordering digital platforms, the CMA found the restaurant food ordering and delivery industry was dynamic and evolving. While Just Eat was currently in a strong position, it was being challenged by well-funded competitors utilizing a different business model. The CMA noted that these competitors had strong brands and technological and logistics experience and expertise and were growing rapidly. For this and other reasons (including the limited competitive constraint Hungryhouse currently imposed on Just Eat), the CMA found the merger would not be expected to result in an SLC.

There are particular challenges in considering digital markets that are rapidly changing and/or where network effects are so strong that the purchase by an incumbent with market power of a nascent firm in an adjacent market could have long lasting effects in preventing a competitor emerging. In 2012 and 2013, the CMA’s predecessor, the OFT, considered the Facebook/Instagram and Google/Waze mergers. In these cases, the OFT considered theories of harm related to loss of potential competition and future exclusion of competing networks, but did not find sufficient evidence to support them. With the benefit of hindsight, a key challenge posed by such cases in digital markets relates to assessing what may be a small possibility of a large reduction in competition. This may require the competition authority to consider the possible future development paths of digital markets, for which there are unlikely to be precedent or historical data available. The CMA believes this represents a very important challenge facing the competition authorities at present.

The CMA considers there are two main risks in recognizing dynamic non-price effects in merger reviews. First, there may be greater uncertainty associated with such effects, since it may generally be more difficult to test dynamic theories of harm: as a result, there is a risk of the SLC decision being wrong if dynamic effects are under- or over-estimated. Secondly, however, there is a risk of not placing sufficient weight on dynamic effects simply because they are uncertain and more difficult to quantify. Given the importance of dynamic competition and innovation to consumer welfare, it is very important,
as the CMA Chairman has noted, to take them into account, i.e. to be ‘roughly right rather than exactly wrong’. The judgement of the Competition Appeal Tribunal in the Intercontinental Exchange/Trayport case supported the CMA’s ability to use qualitative evidence to reach conclusions on dynamic competition.

2.2. Static NPEs

The CMA will consider static NPEs when the rivalry that is relevant to the assessment of the merger is focussed on one or more of quality, range and service instead of, or as well as, on price. Circumstances where this is the case include:

- When price competition is non-existent or unimportant. This is the case when there is a regulated price or a binding price cap, for example in public services or regulated markets, such as rail, pharmacies, dentistry, casinos, hospitals, public transport and water. The CMA and its predecessors have blocked or required remedies for such mergers. Examples include the Celesio/Sainsbury pharmacy merger, the Rank/Gala casino merger, the Poole Hospital/Royal Bournemouth and Christchurch Hospitals merger, and a number of mergers involving rail and regulated water companies.

- To assess rivalry at the local level when the firms concerned have uniform national prices and this is not expected to change as a result of the merger. This is the case in some retail mergers, where the CMA has on occasion found local SLCs and required remedies. In these cases, the CMA would not necessarily distinguish between price effects and NPEs. In Ladbrokes/Coral, the CMA found that the parties set their odds uniformly across all of their stores but varied some price and quality elements of their retail offer in response to local competition. The CMA therefore assessed the effect of the merger both on national and local competition, though adverse effects were found only in relation to local competition.

- Two-sided markets, where one side of the market does not pay. Examples of such markets where the consumers’ side does not pay and the CMA has considered mergers include food ordering digital platforms, shopping centres, free-to-air radio and TV. While the CMA has considered non-price effects in such cases, there are no recent cases where adverse findings have related to such non-price effects.

- Vertical mergers, where the theory of harm relates to a foreclosure strategy involving non-price effects. In Intercontinental Exchange/Trayport, the CMA found, in addition to the dynamic effects, that the merger would have an impact on the terms offered to traders, including a potential increase in execution or clearing fees, a degradation in service offering or reduction in discounts, rebates and fee holidays, and fewer ‘market maker’ agreements offered to traders in order to retain or generate liquidity on a particular venue. In Heineken/Punch Taverns, a merger involving the brewing and retailing of beer, the CMA assessed whether Heineken, given its position as a brewer, would have had the incentive, after the merger, to change the range of drinks offered in Punch pubs. The CMA did not find concerns in this regard, given the lack of incentives of the merged entity to reduce the range of choices.

Celesio/Sainsbury’s involved the acquisition by Lloyds (owned by Celesio) of Sainsbury’s instore pharmacy business. Pharmacies have no control over most prices to consumers and are subject to regulatory and licencing arrangements, which differ slightly in England, Scotland, Wales and Northern Ireland, but principally: (a) require that the pharmacy meet certain quality and service standards; (b) set prices and allowances based on a centralized drug tariff; and (c) due to the structure of allowances, the more prescriptions a pharmacy is able to fulfil, the higher its income. This gives pharmacies the incentive to compete to attract more patients.

In carrying out its assessment, the CMA analysed the results of a survey to assess which elements of the retail offer were important for customers when choosing between pharmacies. The CMA then considered whether there was general evidence to suggest that non-price competition was occurring between pharmacies by looking at internal documents, third party comments and entry/exit analysis. The CMA also sought evidence that there was current competition at a local level. This was based on: (a) internal documents advising local pharmacy managers on how to respond to competition; (b) internal documents setting out

14 Intercontinental Exchange v Competition and Markets Authority [2017 CAT 6, paras 264–265.
17 Royal Bournemouth and Christchurch Hospitals NHS Foundation Trust / Poole Hospital NHS Foundation Trust, Final Report (17 October 2013).
18 Since there is limited direct competition between water companies at the distribution level, the CMA’s task is to assess whether the merger prejudices the ability of the regulator, Ofwat, to make comparisons between companies: see CMA, Water and sewerage mergers, Guidance on the CMA’s procedure and assessment (CMA49, 13 November 2015), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/476839/Water_merger_guidance.pdf.
19 Ladbrokes/Coral (fn 8).
20 Just Eat/Hungryhouse (fn 7).
21 The CMA’s adverse findings in radio and TV mergers have related to the effect on advertisers rather than viewers.
22 Intercontinental Exchange/Trayport (fn 6).
23 Heineken/Punch Taverns (13 June 2017).
changes to local stores in response to competition; and (c) an empirical analysis of the relationship between quality and concentration, which focused on the local variation of profit margins and a set of quality parameters, including opening hours, average waiting times, years since refurbishment, locum hours, and mystery shopper ratings.

Based on the above evidence, the CMA concluded that the parties competed over a number of non-price elements of their retail offer at a local level, for example waiting times, opening hours and raising standard of service and environment above the minimum. The CMA thus found an SLC in 12 areas.

In Carlyle & Palamon/Associated Dental Practices & Integrated Dental Holdings, the OFT assessed, in Phase 1, the acquisition of two dental businesses. The merger occurred in a highly regulated industry where both price and quality are regulated by different public agencies. Several NPEs were highlighted by the parties and third parties. These included the length of the waiting list for an appointment, the length of waiting time at the practice before an appointment, the convenience of opening hours, the general quality of the practice environment and patients’ ease of access to the practice by telephone or internet.

Among other evidence, the OFT reviewed: (a) an econometric analysis submitted by the parties examining whether increasing concentration through the merger may dampen the parties’ non-price offering across a range of aspects of local competition, which used data on profit margins, local market concentration, customer satisfaction survey results, opening hours, marketing expenditure and units of dental activity (a measurement of output) quota fulfilment; (b) two case studies, both submitted by the parties, aimed at providing evidence across a range of factors over the period of the acquisitions in two specific local areas; (c) results from customer satisfaction surveys done internally by the parties during their normal course of business; (d) the opening hours of dental practices and how they (did not) change after past acquisition; and (e) the parties’ delivery performance against their contracted targets.

The OFT believed that the parties would have had the post-merger ability and incentive to vary their NHS dental output through worsening their non-price offering. The OFT accordingly found a realistic prospect of an SLC in NHS dentistry in nine local areas and in NHS orthodontics in one local area.

3. The stage at which non-price effects can be considered in merger reviews

NPEs may potentially be considered at all stages of merger review at Phase 1 and Phase 2 of a CMA investigation, including market definition, competitive assessment and efficiencies.

In relation to market definition, the CMA believes the purpose of market definition is to provide a framework for its analysis of the competitive effects of the merger. The relevant market contains the most significant competitive alternatives available to the customers of the merger firms and includes the sources of competition to the merger firms that are the immediate determinants of the effects of the merger; thus, the CMA’s aim when identifying the relevant market is to include the most relevant constraints on behaviour of the merging firms. Market definition is a useful tool, but not an end in itself, as the boundaries of the market do not determine the outcome of the CMA’s substantive analysis of the competitive effects of the merger in any mechanistic way and there may be substantial overlap between market definition and competitive assessment.

Therefore, where rivalry between the merging firms and their competitors is focussed on non-price aspects, this would play a role in market definition. The hypothetical monopolist test would need to be carried out with respect to a small but significant deterioration in quality or other non-price parameter, rather than a small but significant increase in price. The CMA believes that broadly the same evidence is likely to be relevant to market definition in cases where rivalry is focussed on non-price factors as where it is focussed on price. For example, in Just Eat/Hungryhouse, the CMA assessed the substitutability of firms providing delivery (such as Deliveroo and Uber Eats) for established food ordering firms (such as the parties) using: (i) cross-sectional econometric evidence relating the level of Just Eat’s local orders to the local presence or absence of Deliveroo and Uber Eats; and (ii) consumer survey evidence on which providers they would consider if the food ordering firm closed.

As discussed above, the CMA will consider NPEs, where relevant, in the assessment of competitive effects and efficiencies.

Under UK merger legislation, the CMA can consider countervailing efficiencies in two ways:

- the CMA may be satisfied there is not an SLC if there are rivalry-enhancing efficiencies specific to the

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24 Carlyle Group/Palamon Capital/Associated Dental Practices and Integrated Dental Holdings Group (10 June 2011).
25 Merger Assessment Guidelines (fn 1), paras 5.1.1 and 5.2.1–5.2.2.
26 Just Eat/Hungryhouse (fn 7).
27 See section 2 above on dynamic and static NPEs.
merger, which are timely, likely and sufficient to offset the adverse effects of the merger;28 or
- where the CMA has found an SLC, the CMA may decide to impose no remedy if the merger gives rise to sufficient relevant customer benefits (‘RCBs’). RCBs are defined as lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom … or greater innovation in relation to such goods or services.29 RCBs do not have to occur in respect of the same products, or benefit the same customer groups, as affected by the SLC.

The CMA has recently cleared three hospital mergers which it expected to lead to quality of service improvements, which qualified as relevant customer benefits to patients.30 The CMA is not aware of other recent examples where efficiencies have offset the adverse effect of the merger.

The healthcare system in the UK provides for competition among NHS ‘foundation trusts’, semi-autonomous organizations that provide clinical services. Although healthcare services are ‘free for the patient at the point of delivery’, commissioning organizations procure and pay a consideration for the provision of such services, depending on the number of patients that are treated at the hospital. NHS foundation trusts have the incentive to re-invest such income to attract patients.

NHS foundation trusts are subject to regulation. This regulation does not prevent those providers (either publicly or privately controlled) from maintaining sufficient scope of autonomy to make organizational, financial and other operational decisions with a substantial impact on the competitive structure of the sector. They are also subject to the same merger control regime as other enterprises.

In University Hospitals Birmingham NHS Foundation Trust/Heart of England NHS Foundation Trust,31 the CMA found that the merging hospitals were close alternatives for patients in a number of NHS elective services (services that are typically planned or scheduled in advance and that usually require a referral from a GP or other primary care provider), with only one other district general hospital in the local vicinity remaining post-merger. Therefore, the CMA concluded that the merger gave rise to a realistic prospect of a substantial lessening of competition as a result of horizontal unilateral effects in the supply of 25 elective specialties.

NHS Improvement, the healthcare regulator, advised the CMA that the merger would deliver two types of relevant consumer benefits, i.e.: (a) hospital-wide ‘cross-cutting’ improvements; and (b) speciality-specific improvements.

The CMA considered that these benefits qualified as RCBs, and considered whether they would outweigh the competition concerns identified. In doing this, the CMA looked at: (a) the number of patients affected by the RCBs; (b) the probability with which these RCBs would occur; and (c) the nature and magnitude of the SLC. As a result, the CMA concluded that the RCBs arising from the merger outweighed the potential adverse effects of the SLCs identified. The CMA therefore exercised its discretion not to refer the merger for an in-depth Phase 2 assessment.

Where non-price aspects of rivalry are important and the CMA is concerned about the loss of competition, it would be usual for the parties to raise off-setting efficiency points. For example, in ICE/Trayport, the CMA found the merger would have adversely affected the service received by traders while the parties submitted the merger would give rise to benefits to traders.32

When considering potential remedies to the SLCs identified, the usual approach of adopting a structural remedy would be expected to address both price effects and NPEs arising from the SLC. However, in the rarer case of having to rely on non-structural approaches, the price effects and NPEs arising from the SLC would need to be individually identified and addressed. For example, price caps would obviously only control outcomes in terms of pricing, while access remedies frequently require explicit controls around service or quality measures in the form of service level agreements or similar arrangements. Designing such NPE controls is often even more complex than the equivalent for price due to the large number of potential parameters which could be important and the need for ongoing monitoring.

4. Practical considerations in assessing non-price effects in mergers

The broad categories of evidence the CMA considers in merger cases are: (a) the merging parties’ internal documents; (b) submissions and documents (including relevant industry reports) from third parties, mainly customers and competitors; (c) data collected by the CMA from the parties and third parties, such as quantities supplied, prices,
margins, quality, range and investments (which may be in fixed assets, working capital and/or research and development); and (d) consumer surveys.

The specific evidence obtained will depend on the details of the case concerned, including how the parties compete. For example, the CMA would be more likely to obtain data on research and development plans and patents when innovation is important to competition and more likely to obtain data on service level (e.g. opening hours or information about range) when service competition is important.

In considering the evidence available in an individual merger case, the CMA will consider whether it is probative both directly of the importance of rivalry between the merging parties and of the effects (both price and non-price) of the merger on competition and RCBs.

The CMA will consider the evidence in the round and reach a conclusion as to whether the merger may be expected to result in an SLC and, if it does so, whether there are RCBs that mean no remedy should be imposed. This could require weighing price effects against non-price effects if price effects go in one direction and non-price effects in another.

The CMA considers that price effects are easier to measure than some non-price elements of competition, such as quality of service. However, the CMA has found indirect measures of quality that can be used in quantitative work. For example, in Ladbrokes/Coral, the CMA assessed the impact of the opening of new local betting offices on the merging parties’ refurbishment of their own betting offices. The CMA found that the merging parties responded to the opening of new betting offices in a local area by refurbishing their own local betting offices, with the implication that greater local competition was associated with a better quality of service to customers.33 In any event, the CMA does not consider that price effects should have a larger weight in the assessment simply because they are more easily quantifiable.

Moreover, some quantitative techniques can be used irrespective of whether rivalry is focused on price or non-price aspects. Examples include market shares, diversion ratios34 and GUPPI,35 although if price competition is unimportant, GUPPI estimates would relate to the post-merger incentive to deteriorate quality, range, etc. and not to price.

33 Ladbrokes/Coral (fn 8).
34 If competition on price was unimportant, diversion ratios would relate to customers’ response to a deterioration in non-price aspects of the offer. The CMA often measures diversion ratios using a forced diversion question from a customer survey (i.e. asking customers what they would do if a particular firm outlet or firm was no longer operating) for practical reasons. This question is not affected by whether rivalry is price or non-price focused.
35 Gross Upward Pricing Pressure Index. In some earlier cases, the CMA’s predecessors calculated illustrative price rises rather than GUPPI.