Competition & Markets Authority

PRIVATE HEALTHCARE REMITTAL

Correction to the provisional decision on remedies: revised net present value analysis

1. On 22 March 2016, we published our remittal provisional decision on remedies (PDR) required to remedy the adverse effects on competition (AECs) and the resulting customer detriment we have provisionally found.

2. In Section 1 of the remittal PDR document, we provisionally found that large-scale entry in central London is likely to take place by early 2020 and it is likely to be an effective competitive constraint on HCA by early 2022. On this basis, in Section 2, we found that divestiture, although an effective remedy, would not be proportionate.

3. In order to assess the proportionality of our divestiture package, we took into account both the quantifiable costs and benefits of divestiture and the potential impact on the quality and range of services offered in central London. In the case of the former, we quantified the costs and benefits and carried out a net present value (NPV) calculation (set out in more detail in the Appendix to the remittal PDR), whereas, in the case of the latter, we conducted a qualitative assessment.

4. In coming to a range of estimates of the likely impact of the divestment, we made an assessment of the price, and hence, revenue impact of any divestment, the relevant time period over which any impact would be expected to last, and the extent of any loss of scale economies and transaction costs that should be balanced against any price benefits in the market. These considerations are set out in detail in the Appendix to the remittal PDR.

5. Since publication of the PDR, we have revisited the NPV analysis and found an error in relation to the UK insured revenues. The error consisted of a 'hardcoded cell'[1] fixed at 5% reduction in UK insured revenues, rather than a reference to an input cell which changed for each scenario analysed (eg 3% and 6%). We have rectified this error. Therefore, our NPV analysis output discussed in paragraphs 2.50 and 2.54 of the remittal PDR, and again in

[1] Hard coding is a term used in computer programming. In Excel, it means using specific amounts in formulae or code instead of using calculated or referenced amounts.

paragraph 40 of the Appendix to the remittal PDR, as well as in Table 2.1 in the remittal PDR and Table 8 in the Appendix to the remittal PDR, has changed.

6. The following paragraphs (7 to 12) replace paragraphs 2.50 to 2.55 in the PDR.

7. The results of our revised analysis are set out in revised Table 2.1, below. This shows that the impact of divestiture in the base case is negative under either price reduction scenario over a three-year period. The impact of divestiture is negative (–£18.5 million) under the 3% price reduction and positive (£15.4 million) under the 6% price reduction scenario over a five-year period. Over a seven- or ten-year period, the impact of divestiture is negative under a 3% price reduction in the base case scenario and positive under a 6% price reduction.

Revised Table 2.1: NPV of divestiture

				(£'000)
NPV estimate	*UK self pay & insured sensitivities*			
	3.0%			
Loss of economies of scale	*Year 3 (2019/20)*	*Year 5 (2021/22)*	*Year 7 (2023/24)*	*Year 10 (2025/26)*
£[✂] million – downside case	(35,855)	(38,770)	(41,492)	(45,238)
£8.2 million – base case	(23,248)	(18,453)	(13,976)	(7,813)
£0 million – upside case	(274)	18,571	36,163	60,383
	6.0%			
£[✂] million – downside case	(20,801)	(4,871)	10,000	30,473
£8.2 million – base case	(8,194)	15,446	37,515	67,898
£0 million – upside case	14,779	52,470	87,654	136,094

Source: CMA analysis.
Note: The dates set out in the table assume that divestiture takes place within nine months of the date of our Final Order, ie by September 2017.

8. The NPV analysis indicates that whether the overall impact of divestiture is positive or negative depends on the assumptions that are made around the potential losses of economies of scale, the likely price benefits and the time period over which divestiture has an incremental effect (ie the period of time that elapses prior to entry on a sufficient scale to effectively constrain HCA). We note that there is material uncertainty around each of these factors; however, on a number of plausible combinations of assumptions, the NPV is negative.

9. As set out in paragraph 1.85 of the PDR, our provisional view is that entry by Cleveland Clinic (primarily)[2] is likely, together with other non-HCA hospitals, to act as an effective competitive constraint on HCA by early 2022, which

[2] Entry by smaller operators, such as [✂] via the Barts PPU, is also likely to have an incremental effect in terms of constraining HCA.

corresponds to year 5 in our NPV analysis. For this reason, we have placed most weight on the '5 year' scenarios in Table 2.1.

10. In terms of the estimated loss of economies of scale, we considered that most weight should be placed on the base case and downside scenarios (with less emphasis given to the upside scenario). While our review of HCA's submissions indicated that the £[✂] million estimate was likely to overstate the actual losses, we thought that HCA was likely to suffer some losses of economies of scale as the result of being required to divest a significant proportion of its central London operations. Therefore, we consider that the upside scenario assumption of zero loss of economies of scale is likely to overstate the NPV of the divestiture remedy.

11. We also note that our assumptions are, in some respects, based on analyses which contain further assumptions. For instance, the estimated price reductions are based in material part on our profitability assessment. In that context, our analysis of returns by patient type (UK and overseas) has required a number of judgements and assumptions. There is accordingly significant uncertainty over the likely level of price benefits that would result from a divestiture. In light of this uncertainty and the range of NPVs – from –£39.0 million to £52.0 million (five-year period) – our current view remains that divestiture is not a proportionate remedy as we could not form an expectation that the benefits of the remedy would outweigh the costs.

12. Finally, we considered whether a divestiture remedy could be expected to give rise to any non-price benefits that we should take into account. While we have not identified detriment in the form of a lack of quality and/or innovation in the market, in the Final Report, we concluded that an increase in rivalry resulting from a divestiture remedy could be expected to increase competition on quality and range (not just on price) and an improvement in the quality of hospital services over time.[3] While we still consider that a divestiture could stimulate such investment, we noted that the expected entry of Cleveland Clinic meant that any such (incremental) quality and/or innovation benefits were likely to be short-lived. On this basis, we have not placed weight on such non-price benefits in our assessment of proportionality.

13. Following the revised NPV analysis, our provisional conclusion remains unchanged, therefore, that our proposed divestiture package for HCA does not meet our criteria for a proportionate remedy. While the remedy would be effective in achieving its legitimate aim, ie the increase in competition in the market for privately funded healthcare services in central London, and the

[3] Final Report, paragraph 11.225. PFs, paragraph 7.3.

divestiture packages, as set out in paragraph 2.6 of the remittal PDR, represent the least onerous effective remedy, we could not form an expectation that the benefits of such a remedy would outweigh its costs.

14. We have not, at this stage, made a final decision regarding the existence and form of any AEC and/or its resulting customer detriment. Our final decisions on any AEC, and appropriate remedies, will take into account the responses we have received to our PFs, and the responses we receive to this PDR.

15. Based on the analysis discussed in this correction, our conclusion in the remittal PDR remains unchanged.

6 April 2016

Correction to net present value analysis

1. The following paragraph (2) replaces paragraph 40 and the Revised Table 8 below replaces Table 8 in the Appendix to the PDR.

2. Table 8 below shows our estimates of the likely impact on revenues of the divestiture of HCA's hospitals. Our 'base case' estimates indicate net benefits of between –£18.5 million and £15.4 million over five years when assuming a 3% to 6% decrease in HCA tariffs. Our 'upside case' estimate is of net benefit of between £18.6 million and £52.5 million, while the 'downside case' estimate gives negative results (between –£38.8 million and –£4.9 million), meaning that there would be net costs over a five-year period.

Revised Table 8: NPV of divestiture

(£'000)

NPV estimate	*UK self pay & insured sensitivities*			
	3.0%			
Loss of economies of scale	*Year 3 (2019/20)*	*Year 5 (2021/22)*	*Year 7 (2023/24)*	*Year 10 (2025/26)*
£[✂] million – downside case	(35,855)	(38,770)	(41,492)	(45,238)
£8.2 million – base case	(23,248)	(18,453)	(13,976)	(7,813)
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Source: CMA analysis.