William Hill PLC

Response to the Competition and Market Authority's (**CMA**) provisional findings report (**Provisional Findings**) in respect of the proposed acquisition by Ladbrokes plc of Gala Coral Group

Background

1 William Hill (WH) is broadly supportive of the CMA's Provisional Findings and welcomes the opportunity to provide some more detailed comments on some aspects of the CMA's analysis. In particular WH sets out below its comments on the CMA's local market analysis, assessment of local effects and national theories of harm. A number of these points also feed into WH's response to the CMA's Remedies Notice, on which WH has already provided comments.

The CMA's local market analysis

2 The CMA has assessed the impact of the merger on the retail supply of gambling products at a local level. In particular, the CMA has assessed the impact of the merger in those local areas where the merging parties both have at least one LBO using a weighted share of shops (WSS) approach.[1]

3 The CMA considers that the competitive strength of merging parties in any given local area can be approximated based on the number and location of their LBOs and the LBOs of competing operators.

4 This is based on evidence collected by the CMA, including:

(a) an analysis of entry/exit decisions, which demonstrates the significance of distance/location of other large national fascia/independents on the merging parties' decisions to open new LBOs, with a weaker effect identified for independent LBOs;[2]

(b) the importance of the distance of competitors to the merging parties' refurbishment requests, which demonstrates the impact that "competitive events" have on the decision on whether to refurbish an LBO, and how this changes as the distance between the competitive event and the centroid LBO increases;[3]

(c) an analysis of the number of concessions offered, which demonstrates that the incremental impact of a competitor on the number of concessions offered depends on the location of the competitor and the number of other competitors present in the local area. The analysis also indicated that there was no difference in the results for LBOs of national chains and independent LBOs;[4] and

(d) an analysis of diversion ratios estimated from survey evidence, which demonstrates the importance of distance to a consumers' choice of alternative LBO.[5] The analysis also

[1] Provisional Findings at paragraph 7.110

[2] Paragraph 7.13

[3] Paragraph 7.22

[4] Paragraph 7.33

[5] Paragraph 7.36

demonstrates that LBOs of national players are closer competitors to the merging parties than independent LBOs.[6] It corroborates the CMA's entry/exit analysis finding that independent LBOs cause a weaker constraint than national players. In addition, the CMA found that the geographically closest LBO to the LBO surveyed attracts more diversion than would be expected based on distance alone).

5 Based on the evidence set out above, the CMA considers that the competitive constraint of rivals' LBOs decreases substantially with distance, and that the merging parties' decisions regarding the operation of individual LBOs is affected primarily by competing LBOs located within 400m. The CMA also concludes that the closer a competing LBO is, the stronger is the competitive constraint it exerts, and the strength of this constraint is stronger than distance alone would suggest, i.e., the constraint is not linear with distance.[7]

6 We do not disagree with the broad conclusions drawn by the CMA, that individual LBOs compete more strongly with LBOs that are located closer than with LBOs located a further distance away. We are, however, concerned that the CMA's local market analysis is overly simplistic in places and that it relies upon assumptions that do not appear to be supported by the facts of the case. This could, potentially, lead the CMA to understate the number of local areas in which the transaction may be expected to result in an SLC. The areas of our concern include, inter alia:

(a) The CMA has used "as the crow flies" distances in its local market analysis.[8] Catchments based on walk times are likely to be substantially more relevant given the nature of LBO business, where features of the local geography[9] can significantly impact the competitive constraints. These considerations certainly [✂] and could potentially have a profound effect on the results of the analysis. It is not apparent on the face of the PFs whether the CMA has sensitivity tested for this in making its choice and therefore we cannot judge whether it is well founded.

(b) While the CMA has considered whether the LBOs are located in urban or rural locations, it has not fully accounted for population density around each LBO. WH understands the difficulties in undertaking local market analysis across a large number of areas. However, the degree to which two LBOs compete with each other depends not only on physically how close they are located to each other, but also on the location of consumers, who will not be evenly spread over each 400m concentric circle. If for example, two LBOs are located 400m apart and serve consumers in a housing estate which is located in between the two LBOs, then the degree of competition between them will be substantially greater than has been estimated by the CMA. We do not know how many of the CMA's local area analyses will be affected by this, but given the small size of catchment areas, we consider it could potentially have a material effect on the CMA's results and, in some cases, could imply greater competition between certain LBOs than the CMA has concluded.

(c) For example, as illustrated in the maps attached concerning LBOs in Reading town centre, a 100m radius contains 5 LBOs, rising to 11 LBOs within 400m. A look at the maps shows this is capturing two distinct centres within Reading, each with its own local competitive

[6] Paragraph 7.40(c)

[7] Paragraph 7.23

[8] Paragraph 22 of Appendix E

[9] For example, physical features that can profoundly affect how long it takes consumers to walk to a LBO include crossing a dual carriage road, railway crossings, subways, rivers, etc.

dynamic – one centred around Queen Victoria Street (7 LBOs) and other centred around the junction of Broad Street and West Street (4 LBOs). A similar location is East Ham – a linear High Street retail development where a 100m radius from a central unit captures 2 LBO fascia. This increases to 6 at 200m and 10 at 400m. Therefore it can bee seen that there are effectively three locations in East Ham when considering the attached map: the top, middle and the bottom of the High Street. Finally, Newcastle Upon Tyne is a city centre location where at 100m there are 5 LBOs, which then increases to 9 at 200m and 14 at 400m, with a further two peripheral locations. From the attached map it can be seen that there are 5 separate identifiable locations within the city centre. This further underscores the need for the CMA to apply a more nuanced approach to the distance of competitor stores.

(d) The CMA provisionally concludes that a WSS range of 30% to 40% is consistent with the evidence available to it, and, following further analysis, that a WSS threshold of 35% should be used:

- First, the CMA uses its predicted diversion ratios to examine the relationship between diversion ratios and corresponding WSS figures for the Parties' LBOs.[10]

- Second, it uses this relationship, and GUPPIs it estimates based on the Parties' variable margins, to consider a *"plausible intervention threshold"*.[11] The CMA states that, given the Parties' variable margins, it expects the merger to have *"a significant impact on pricing incentives even where diversion ratios are relatively low"*.[12] It suggests diversion ratios that may cause concern are from 15% to 20%, and that these diversion ratios correspond to a GUPPI from 10-20% to 10-20%.

- Third, the CMA states that this intervention threshold has a corresponding WSS range from 30% to 40%. It goes on to use the evidence it gathered and analysis from Tables 6, 7 and 10 to justify this range, and conducts further analysis to justify a 35% threshold (as opposed to 30% or 40%). It explains that a 30% threshold is too low, because it *"'fails' a significant proportion of LBOs that belong to categories of areas where we did not identify a strong relationship between concentration and competitive outcomes."*

WH's reading of the evidence used by the CMA – albeit heavily redacted – is that the 30% to 40% WSS range identified, and the 35% WSS intervention threshold used, is likely to be too high. The CMA is at risk of clearing a number of local markets which may be subject to a substantial loss of competition:

- First, WH considers that the range of diversion ratios used may be too high. The diversion ratios used by the CMA correspond to GUPPIs of between 10% and 20%, i.e. a GUPPI of at least 10%. The CMA itself acknowledges that a GUPPI in the magnitude of 10% has been used to indicate competition concerns at the UK and EU level,[13] suggesting the lower bound of the range used by the CMA is too high.

(e) The CMA's approach when using its 35% WSS threshold is also flawed. The CMA's justification of a 35% threshold is due to the 30% threshold failing a *"significant proportion"* of

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[10] Figure 20 and paragraph 7.110

[11] Paragraphs 7.111-7.112

[12] Paragraph 7.111

[13] Footnote 97

areas which it considers do not give rise to a substantive loss of competition.[14] From this point forward in its analysis the CMA only considers the 35% WSS threshold. This means that the CMA has not considered:

- the large number of local areas presented at Figure 20 which, despite having a WSS of less than 35%, have very high estimated diversion ratios (and, in turn, provide the parties with a material incentive to worsen the overall product offering in these areas); or,
- the large number of local areas in Table 14 which are not present in Table 15, yet result in local market consolidation of 2:1 or 3:2 on a fascia count basis post-merger.

In short, the CMA has left a significant "one sided" gap in its approach. While it considers the areas a 35% WSS threshold "fails" but may not be problematic, it does not consider, and appears to have wholly disregarded, areas that a 35% threshold passes despite these likely being areas where a substantive lessening of competition is expected.

(f) In addition to the WSS threshold of 35% set by the CMA both a) seeming too high based on the available evidence, and b) its approach once that threshold is selected being "one-sided", WH has a number of concerns in the calculation of the WSS. In fact, the CMA's approach to calculating the WSS may be significantly biasing the WSS figures. These errors may lead the CMA to understate the number of local areas where a substantive loss of competition would be expected:

(i) In calculating WSSs for each LBO, as per the equations set out in paragraphs 7.78 and 7.81, the CMA places more weight on competitive constraints from closer LBOs than LBOs that are further away from the centroid LBO. Although this is not necessarily an unreasonable assumption (subject to the concerns raised above), we note that the CMA is making a strong assumption regarding the functional form by which this relationship is captured, and relies on only one possible sensitivity analysis reflecting this assumption.

(ii) In paragraph 7.77, the CMA states that because it considers that the geographically closest LBO tends to offer the strongest competitive constraint, they have increased the weights on these LBOs by a factor of 1.2. This would seem to be a wholly arbitrary weighting. Also, it is not adequately explained why a factor of 1.2, as opposed to 1.1 or 1.3 for example, is considered correct, nor why a single sensitivity analysis which relies on a weighting of 1.3 would be appropriate.

(g) In paragraph 7.89, it is stated that independents exert less competitive pressure than the national operators and, as such, they are given a weight of 0.9 in the WSS calculations. The scaling factor of 0.9 would again appear to be arbitrary. Similarly, while the CMA conducts a sensitivity analysis based on a weighting of 0.8, the CMA does not clearly explain why this would be an appropriate sensitivity to test. In fact, WH considers that the CMA's evidentiary base[15], which shows strong support for a view that independents exert less competitive

[14] Paragraph 7.117

[15] Including evidence from third parties, entry/exit analysis, and the CMA's own econometric analysis

pressure, suggests the weighting placed on independents could, and likely should, be even lower than the CMA's sensitivity.[16]

(h) After the WSS analysis is conducted, the CMA reverts to a simple fascia count to remove areas with four or more competing LBOs (paragraph 7.130-2). Again, this is an arbitrary assumption and it contradicts other evidence cited by the CMA on importance of location and number of merging parties' fascia within a given local area.

7 In paragraph 7.97, the CMA rejects WH's recommendation to remove at risk LBOs from the analysis. Its reasoning for doing so is, we consider, incorrect:

(a) The CMA says that it cannot be ruled out that some of the closed LBOs might be acquired by another LBO operator. There is little evidence for this assumption. Indeed [✂].

(b) The consensus of the ABB members, including the merging parties, is that all of the LBOs identified at risk in the KPMG analysis would be closed and would not be acquired by other bookmakers.

(c) Insofar as there is a material risk that the LBOs identified in the KPMG analysis will be closed in the near future, as is the belief of the bookmaking industry including the merging parties and the ABB, then we consider it important to at least understand the possible impact on the CMA's results should the local market analysis be re-run excluding these LBOs. If it turns out that it would have little effect on the number of local areas in which the transaction may be expected to result in an SLC, then this would help to corroborate the CMA's findings. If, on the other hand, it would tend to increase the number of local areas in which the transaction may be expected to result in an SLC, then we consider it would be remiss of the CMA to not be aware of this and to consider in more detail the possible effects of the proposed merger on future competition in the light of this.

8 Taken in summary, we are concerned that the assumptions used in the CMA's geographical market analysis could result in some significant inaccuracies in its conclusions. Potentially, some of the assumptions used and the approaches adopted could result in an understatement of local areas in which the transaction may be expected to result in an SLC.

The CMA's analysis of aggregated local effects

9 The CMA has assessed whether there could be a loss of competition at a national level as a result of the aggregated loss of competition in the various areas where the merging parties operate. In particular, the CMA considered that there could be an incentive for the merging parties to worsen those parameters of competition set centrally (such as odds in sports betting and promotions, betting limits) if customers view the merging parties' LBOs as close substitutes.

10 WH agrees with the CMA that it is important to consider possible national effects of the merger as the competitive constraint of a given operator is more than a simple aggregation of its competitive constraint in each local market. This is supported by evidence available to the CMA on the differential between the competitive constraints from national chains and independent LBOs, and the very high fixed costs of operation which have significant implications for the minimum efficient scale of operation.

[16] For example, the CMA's econometric analysis shows a negative and statistically significant relationship between diversion ratios and whether an LBO is an independent. However, the only independent considered in the CMA's econometric analysis was Jennings, which is, as the CMA acknowledges at footnote 74, a significantly larger competitor (100+ stores) than the majority of small independent bookmakers. The majority of independents exert less competitive pressure.

The CMA's assessment of national theories of harm

11 Finally, when considering national theories of harm, the CMA assessed the potential for the merger to result in a loss of competition relating to innovation. In particular, if innovation is facilitated or stimulated by large suppliers in the market, the merger (by reducing the number of large players) could have a detrimental impact on innovation which would be compounded if only large players innovate and/or the merging parties are leaders in innovation.[17]

12 In reaching the conclusion that the merger would not give rise to a substantial loss in innovation, the CMA referred to the fact that innovations adopted by LBOs are frequently developed by third parties, and also that the drivers of innovation are not limited to competition between LBOs.[18]

13 While both of these factors should be considered by the CMA as part of its analysis, the CMA cannot assume that the merger will have no impact as innovations are typically developed by third parties. The demand faced by third party developers is driven by a range factors, including competition between gaming and betting providers. Although third parties may in many cases have been responsible for initiating innovations, developing these innovations on a national scale has required the resources of competitively attuned national players. As the CMA notes, the parties' internal documents indicate that they do try to differentiate themselves through innovation, which is likely to impact the demand for developments by third parties. A reduction in competition as a result of the merger could therefore reduce the incentives faced by third parties to develop innovations, impacting the level of innovation in LBOs.

14 Moreover, some innovation is directly sponsored by national chains. For example, WH provides an accelerator fund which offers financial, technical and business support to third parties (primarily start-up or early-stage companies) to innovate. A reduction in competition as a result of the merger could therefore reduce the incentives for national chains to actively seek out and promote innovation.

[17] Paragraph 9.51

[18] Paragraph 9.62