COMPLETED ACQUISITION BY CYGNET HEALTH CARE LIMITED AND UNIVERSAL HEALTH SERVICES, INC. OF THE CAMBIAN ADULT SERVICES DIVISION OF CAMBIAN GROUP PLC

Statement of issues

9 June 2017

The reference and our issues statement

1. On 3 May 2017, the Competition and Markets Authority (CMA), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the Act), referred the completed acquisition by Universal Health Services, Inc. (UHS) via its wholly-owned subsidiary Cygnet Health Care Limited (Cygnet), of the Cambian Adult Services division (CAS)[1] of Cambian Group plc (the Merger) for further investigation and report by a group of CMA panel members.

2. In exercise of its duty under section 35(1) of the Act, the CMA must decide:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

3. In this statement, we set out the main issues we are likely to consider in reaching our decision. This does not preclude the consideration of any other issues which may be identified during our investigation.

Background

4. UHS is a US healthcare management company listed on the New York Stock Exchange. Through its subsidiaries, UHS operates acute care hospitals, behavioural health facilities and ambulatory centres in the USA, UK, Puerto Rico and the US Virgin Islands.

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[1] Comprising Care Aspirations Developments Limited, Cambian Healthcare Limited and Cambian Care Services Limited.

5. In 2014 UHS acquired Cygnet, a company incorporated in England and Wales. Cygnet operates 20 mental health hospitals and two residential nursing homes for the elderly across England. Most of its sites are in Greater London, the South West, the Midlands and Yorkshire. Rehabilitation services are provided within a larger mental health facility at nine of its sites, whereas six sites are dedicated solely to rehabilitation services. Cygnet provides a range of services for individuals suffering from a variety of mental health conditions at different stages of the mental health care pathway. The worldwide turnover for UHS in the year ending 31 December 2016 was around £7,204 million and its turnover in the UK was around £178 million.

6. Cambian Group plc (Cambian) is a UK-based provider of specialist behavioural health services for children and adults (the latter provided by CAS) in the UK. It is listed on the London Stock Exchange. CAS's services include specialist mental health and rehabilitation services and residential care home services for patients with mental health conditions. CAS has 84 facilities within England and Wales, with most sites located in the Midlands and Yorkshire. It provides rehabilitation services at 25 locations; in all but two, these are in facilities dedicated to these services. The turnover of CAS for 2016 was around £142 million.

7. On 28 December 2016 Cygnet acquired CAS pursuant to a sale and purchase agreement dated 5 December 2016. In this document and in this inquiry we will refer to Cygnet and CAS as the Parties and together as the Merged Entity.

8. Both parties operate independent mental health hospitals in the UK. The Parties each provide a range of mental health services for patients at their sites across the UK. These services include treatment for addiction, eating disorders, personality disorders, autistic spectrum disorders and specialist mental healthcare services for children and adolescents. Facilities include low and medium secure mental healthcare, residential care homes, acute and psychiatric intensive care units and hospital-based inpatient mental health rehabilitation.

9. The Parties overlap in the supply of hospital-based inpatient mental health rehabilitation services (Rehabilitation Services) to various customers, including local authorities and NHS clinical commissioning groups (CCGs) in England, and to NHS Wales (together, referred to as Commissioners).[2]

[2] The Parties are active in other service lines, which do not overlap. Unless otherwise stated, these service lines are not considered by the CMA in its competitive assessment.

The markets in which the Parties operate

10. The purpose of market definition is to provide a framework for the analysis of the competitive effects of a merger. The relevant market contains the most significant competitive alternatives available to the customers of the merger firms and the most relevant constraints on the behaviour of the merger firms.[3]

11. However, the boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the CMA may consider constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[4]

12. In general, we note that market definition and the analysis of competitive effects largely overlap since both are driven by considerations relating to the 'closeness' of substitution between the Parties' offers and those of alternatives.

Product

13. As mentioned above, the Parties overlap in the supply of Rehabilitation Services to Commissioners. As a starting point, the CMA will use the product frames of reference at phase 1.[5] That is, we will test the robustness of distinguishing separate product markets within Rehabilitation Services by specialism and by patient gender.

Delineation by specialism (ie patient condition(s) being treated)

14. We understand that the treatment of different patient conditions within Rehabilitation Services takes place at dedicated wards, and patients with one condition would not usually be sent to a ward that specialises in the treatment of a different condition. However, we will assess how broad these specialisms are and the extent to which patients have multiple conditions. We will consider how this impacts on the choice of facility and treatment and the ability of providers to 're-tool' to offer more or less of one type of service or different combination thereof.[6]

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[3] Merger Assessment Guidelines, paragraph 5.2.1.
[4] Merger Assessment Guidelines, paragraph 5.2.2.
[5] See *Completed acquisition by Cygnet Health Care Limited and Universal Health Services, Inc of Care Aspirations Developments Limited, Cambian Healthcare Limited and Cambian Care Services Limited* ME/6655/16, which is also in line with previous decisional practice, for example, *Completed acquisition of Acadia Healthcare Company, Inc. of Priory Group No.1 Limited*.
[6] See also paragraph 33(b) below.

15. We expect our investigation to focus on the Rehabilitation Services where the Parties overlap: the treatment of Personality Disorders; and the treatment of long-term mental health conditions (LTMH).[7] Although the Parties overlap in two other specialisms (Autistic Spectrum Disorder and Learning Disabilities), due to the lack of geographical proximity of the Parties' sites and the number and location of alternative providers, we will not be investigating these further unless we receive evidence of concerns.

Delineation by patient gender[8]

16. Our initial view is that in addition to specialism(s), there is a demand-side distinction between treating male and female patients. We understand that mixed-gender wards[9] do not represent an alternative for many patients, and in most cases patients of one gender would not be sent to wards treating the other gender. We also note that the Care Quality Commission has a strong preference for single-sex wards for the 'dignity and respect of patients'.[10]

17. We will consider whether there are narrower or broader segmentations where the Parties' offerings may compete in the examination of the closeness of competition. See the section on 'Theories of harm to be investigated by the CMA' below.

18. We will also consider whether the provision of Rehabilitation Services by the NHS itself should be included in the product market definition.[11]

Geographic

19. Our initial view is that the competition for the supply of Rehabilitation Services takes place mainly at a local level. This is because: *(a)* services are purchased and negotiated at a local level;[12] *(b)* Commissioners have a strong and consistent preference across all Rehabilitation Services to minimise the distance between the patient's origin (usually their home) and where they are treated; and *(c)* Commissioners frequently inspect facilities and monitor placements, so a manageable distance between Commissioners and the facility(ies) is important.

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[7] We understand there are different categorisations of mental health conditions in use both by those looking to commission and those looking to provide mental health services. At this stage we use the terms such as LTMH, for consistency with the phase 1 decision but our investigation will seek to define specialisms based on the evidence received.
[8] The phase 1 decision treated LTMH services provided specifically to elderly patients as a separate frame of reference, distinct from LTMH services to other adults. We will take the same approach in our investigation.
[9] There are some mixed-gender facilities.
[10] *Acadia/Priory*, paragraph 343.
[11] See also 'Countervailing factors' below.
[12] Except for Wales, where they are purchased by NHS Wales.

20. A key aspect of the geographic market is the actual distance over which providers compete. To assess this, we will consider the catchment areas for the Parties and their competitors. We will consider whether site-specific catchment areas or treatment-average catchment areas provide a more appropriate geographic market. To do so, we will consider evidence of the ways in which providers compete over different parameters (such as price, quality and capacity) and how these relate to geography. We will also consider how local constraints on bed availability affect the appropriate geographic market.

21. We understand there are gaps in the available data on patient location. Given these, we will assess whether CCG location is a reasonable proxy for patient addresses and draw on the available evidence from CCG referral data to investigate our theories of harm.

22. Notwithstanding the importance of local factors in the competition for the supply of Rehabilitation Services we will also assess how and in what way any national factors could impact on local conditions of competition. Such factors could include reputation, scale, financial strength and viability and access to capital.[13]

Assessment of the competitive effects of the Merger

Counterfactual

23. We will assess the potential effects of the Merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the Merger).

24. As part of our assessment of the counterfactual, we will consider what would have been most likely to have happened if the Merger had not taken place and what would have been the likely conditions of competition in the foreseeable future.

25. In making our assessment, we will consider possible alternative scenarios and decide upon the appropriate counterfactual based on the facts available to us and the extent to which events or circumstances and their consequences are foreseeable.[14]

[13] See also paragraph 36 below.
[14] Merger Assessment Guidelines, paragraph 4.3.2.

Theories of harm to be investigated by the CMA

26. Theories of harm describe the possible ways in which an SLC may be expected to result from a merger, and provide the framework for our analysis of the competitive effects of a merger. We set out below the theories of harm that we are currently minded to investigate. However, we may revise our theories of harm as our inquiry progresses. The identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us, or the receipt of additional evidence. We welcome views on the theories of harm set out below and our proposed approach to its assessment.

27. We are currently considering three horizontal theories of harm relating to the effect of the merger on actual or potential competition at a local level and on potential competition at a national level. The concern under a horizontal (unilateral) effects theory of harm is that the removal of one party as a competitor could allow the remaining suppliers, including the Merged Entity, to increase prices, lower quality, reduce the volume or range of their services and/or reduce innovation, all relative to the counterfactual.

28. As part of our competitive assessment for each of the theories of harm, we will consider the role of the NHS. This will include an examination of how the different ways it commissions services via different bodies (local authorities, single or multiple CCGs, individual or framework contracts) affects the dynamics of competition. It will also consider the NHS as an alternative provider, able to self-supply and meet some of its own demand.

29. Our competitive assessment will also consider the role of regulation and how changes in policy or approach can impact competitive dynamics in local and national markets.

Theory of harm 1: unilateral horizontal effects arising from the loss of actual competition in the supply of Rehabilitation Services at a local level

30. In general, for this theory of harm to be substantiated, the following conditions must be met:

    (a) the Parties are close competitors;

    (b) the Parties have the ability and incentive to vary some aspect of their offering in response to differences in local competition; and

    (c) other competitors are not likely to be able to impose as effective a competitive constraint as the Parties exert on one another.

31. To assess the conditions set out in *(a)–(c)* above, in each local area where the Parties overlap now and in the foreseeable future, we will investigate how competition works in more detail. This will involve an examination of:

- Commissioner choice – if and how the different groups/categories (eg individual CCGs, collectives of CCGs, CCGs in framework contracts, local authorities) choose services in different ways or at different points in the patient journey and how this affects competition;
- how contracts are awarded and negotiated initially and varied over time, what proportion of sales pre-negotiated contracts represent;
- how Commissioners assess/measure prices and provider quality characteristics and the role these play in competition;
- the market shares of the Parties and their competitors, and the numbers of competitors;
- the importance of capacity for competitive dynamics, how this varies by site, specialism and over time;
- the incentives and ability to add capacity and/or change the current capacity by 're-tooling' wards/sites or change other aspects of the local offering; and
- the previous behaviour of the Parties within the local area, including in response to changes in local competition.

32. Our relative focus on each of these factors will depend on the evidence available for each of the local areas, we expect closeness of competition to vary from area to area

Theory of harm 2: unilateral horizontal effects arising from the loss of potential competition in the supply of Rehabilitation Services at a local level

33. Our assessment will consider whether entry or expansion by one or both of the Parties would have occurred absent the Merger and led to substantially greater competition. Our assessment of potential competition will consider the possibility that, absent the merger:

(a) the Parties' expansion plans would be likely to lead to substantially greater competition in certain areas;

(b) the Parties would be likely to switch the use of a hospital or ward from the provision of one treatment or combination of treatments to another resulting in substantially greater competition in certain areas.

Theory of harm 3: unilateral horizontal effects arising from the loss of potential competition in the supply of Rehabilitation Services at a national level

34. Our assessment will consider whether the increased concentration and reduction in the number of major providers would lead to a loss of actual or potential competition. This may be competition in innovation, expansion and investment, for example.

Countervailing factors

35. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find.

Entry and expansion

36. We will consider whether entry or expansion by effective competitors could be expected to be timely, likely and sufficient to prevent any SLC. To do this, we will:

(a) look at the history of entry, expansion and exit by the Parties and by their competitors and review any plans;

(b) consider the costs and time necessary to enter and/or expand for competitors or new entrants;

(c) consider other barriers to entry/expansion including: the existence and duration of framework contracts; the role of the Care Quality Commission and the costs and time required to comply with other legal/regulatory requirements; and

(d) examine other factors that might inhibit entry or the expansion of existing competitors, such as the importance of reputation and any impediments to switching faced by different Commissioners.

Buyer power

37. We will investigate whether Commissioners, individually or collectively have countervailing buyer power, and whether this buyer power would be sufficient to address any effects of an SLC in the local area. We will also consider the ability of the NHS and/or other relevant national bodies (eg the Department of

Health or NHS England) to maximise any buyer power Commissioners may have by changing the way services are commissioned and the likelihood of any such changes happening.

38. We will also examine the extent to which it would be likely for the NHS and/or other relevant national bodies to introduce or change policies to encourage or facilitate entry or expansion.

39. We will also assess the extent to which it would be likely for the NHS to increase the provision of these services itself.

Efficiencies

40. We will examine any evidence available to us in relation to efficiencies arising from the Merger. In particular, whether there are Merger-specific rivalry-enhancing efficiencies that can be expected to mean that the Merger would not result in an SLC.

Possible remedies and relevant customer benefits

41. Should we provisionally conclude that the Merger may be expected to result in an SLC in one or more markets, we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.

42. In any consideration of possible remedies, we may have regard to their effect on any relevant customer benefits that might be expected to arise as a result of the Merger and, if so, what those benefits are likely to be and which customers would benefit.

Responses to the statement of issues

43. Any party wishing to respond to this statement of issues should do so in writing by no later than **5pm on 23 June 2017**.

Please email cygnet.cambian@cma.gsi.gov.uk or write to:

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