

Completed acquisition by Wolseley UK Limited of certain assets from the WT Burden Group including 22 Burden branches

ME/5826/12

The OFT's decision on reference under section 22(1) given on 30 January 2013. Full text of decision published 11 March 2013.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Wolseley UK Limited (WUK)** is a UK distributor of heating and plumbing products, serving professionals in the construction industry through a number of trading brands, namely, Plumb Center, Parts Center, Drain Center, Pipe Center, Climate Center, BCG and Integrated Services. WUK's turnover in the UK for the year-end July 2012 was £1,670 million across all of its trading brands. The most relevant WUK trading brand in the context of the merger is Drain Center, which achieved a turnover in the UK for year-end July 2012 of £[] million, which represented less than [] per cent of WUK's UK turnover.
2. The acquired assets (known as **Tunnel** for convenience) formed part of **Burdens Group** (WT Burden Limited and its subsidiaries). Tunnel is a specialist supplier of civil engineering and building materials to customers in the infrastructure, environmental and construction sectors. The turnover generated by Tunnel assets for the year-end June 2011 was £[] million.

TRANSACTION

3. WUK completed the transaction on 2 November 2012. It acquired Tunnel from WT Burden Limited and certain other members of the Burdens Group, including WTB Group Limited and Burdens Limited (collectively referred to as Burdens). By way of background, Burdens Limited and WTB Group

Limited, two companies within the Burdens Group, appointed administrators on 28 November 2012 and the remaining branches of Burdens were marketed for sale. Seven branches were successfully sold to trade buyers, however, no buyer(s) was found for the remaining nine branches and these ceased trading on or before 21 December 2012.

4. WUK has purchased the following UK assets from Burdens:
 - a) 22 branches (Relevant Branches)¹
 - b) all fixed and loose assets including plant and machinery and vehicles situated at each of the Relevant Branches
 - c) all IT assets used in relation to the Relevant Branches
 - d) all pre-payments relating to Tunnel²
 - e) the goodwill of Tunnel including the right to carry on Tunnel's business under the Burdens name
 - f) all intellectual property relating to Tunnel
 - g) the benefit of certain (smaller) contracts for the supply of products and services to customers and the opportunity to negotiate for the benefit of larger contracts
 - h) all books and records relating to Tunnel, and
 - i) approximately 600 employees, including the employees at the Relevant Branches, regional and national operational sales teams and employees at the head office of Burdens.

5. The OFT received a satisfactory informal submission from WUK on 29 November 2012. Pursuant to its published administrative procedures, the OFT's 40-day administrative timetable expires on 31 January 2013.

JURISDICTION

6. As a result of this transaction WUK and Tunnel have ceased to be distinct. The merger constitutes a relevant merger situation for the purposes of the Enterprise Act 2002 (the Act) as the 22 Burdens branches which were purchased by WUK generated revenue of approximately £[] million in the year ended 30 June 2011, which exceeds the £70 million turnover

¹ Blaydon, Bristol, Cambridge, Cardiff, Exeter, Gatwick, Glasgow, Inverness, Hirwaun, Leeds, Llangadog, Manchester, Newmains, Nottingham, Picketts Lock, Plymouth, Sheffield, St. Asaph, Tadley, Thurrock, Warrington, and West Bromwich.

² Pre-payments are amounts paid in advance of liabilities falling due, the benefit of which will be assumed by WUK.

threshold set out in the Act. The OFT therefore believes a relevant merger situation has been created.

MARKET DEFINITION

7. The parties overlap in the supply of building materials. In particular WUK submit that Drain Center, one of its branded outlets, and the Relevant Branches are both active in the supply of the following products, referred to collectively as drainage products for convenience:

- above ground drainage
- access covers and gratings
- below ground drainage
- construction chemicals
- construction products
- ducting systems
- geotechnical and ground engineering
- metering
- pressure pipelines
- safety and protective equipment
- sustainable drainage solutions
- surface drainage, and
- tanks and separators and environmental products.³

Segmentation by individual product

8. WUK submit that although individual drainage products cannot be viewed as substitutes, the market should not be defined as narrowly as an individual product.

9. Previous decisions of the OFT have considered segmentation by individual building product where there has been a direct overlap between the parties in a specific product grouping. As a result of their different prices, characteristics and intended uses it seems likely that the hypothetical monopoly test would result in individual products constituting different product markets because customers would not respond to a price rise on a particular product by switching to a different drainage product. Therefore

³ The acquired branches also supply hard landscaping products, but WUK do not supply these so they are not considered further.

from the demand side perspective different markets could exist for individual building products.

10. However, as stated in the Merger Assessment Guidelines, the relevant market may not be the narrowest market that meets the hypothetical monopolist test.⁴ In this case, there are a number of reasons why it may not be considered appropriate to define markets with reference to individual product types:
 - a) Customers will often purchase a bundle of products in a single transaction, so products will be in joint demand (see *Jewson/Build Center*).⁵
 - b) Expanding from the supply of one product to another within the same product grouping can be undertaken with ease by a retailer, specifically, drainage merchants tend to stock similar products. The only potential constraint to substitution on the supply side is the size of premises given the need for some core products to be kept in stock.
 - c) Within a product category such as drainage products, products are homogeneous, with little in the way of brand differentiation.
 - d) Additionally, there is no evidence that there is a key product in the market which drives searching or switching behaviour and in essence different customers will require different products.

11. In *Jewson/Build Center*⁶ and *Travis Perkins/BSS*⁷ the parties primarily overlapped in the distribution of building materials and plumbing and heating products respectively. In both cases the OFT did not consider it appropriate to narrow the market by individual products for similar reasons.

Conclusion

12. The OFT's investigation found that there is limited scope for demand side substitution between different drainage products since each product has a specific characteristic and intended use, however customers tend to shop for a notional basket of complementary goods which is suggestive of a

⁴ OFT CC Joint Merger Assessment Guidelines, paragraph 5.2.3

⁵ See paragraph 16.

⁶ Completed acquisition by Saint-Gobain of Build Center, OFT decision of 8 February 2012.

⁷ Anticipated acquisition by Travis Perkins plc of BSS Group plc, OFT decision of 10 December 2010.

wider product market as suppliers need to carry a range of products to compete for customer demand. In addition, the OFT considers that based on supply side factors, it does not seem appropriate to delineate the market with reference to the type of drainage products.

Segmentation by channel

13. WUK submit that the product market should not differentiate between the retail channel drainage products may be sold through, and as such, any firm engaged in their supply should be considered to compete in this market, regardless of the distribution channel they are considered to operate in.
14. The OFT has considered segmentation by channel in previous building materials cases. Of note, in *Saint Gobain/Build Center*, the OFT characterised Burdens as a civil and heavyside specialist, that is a company supplying products to civil engineering, utilities and construction customers and, in doing so, concluded in that case that Burdens do not exert a prima facie competitive constraint on general builders merchants (GBMs)⁸ such as WUK. The OFT has received no evidence to depart from this approach in this case and considers that Burdens are in a separate distribution channel to GBMs.
15. As noted in the Merger Assessment Guidelines, market definition is a useful tool, but not an end in itself. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger, as it is recognised that there can be constraints on merging parties from outside the relevant market.⁹ The OFT has not needed to conclude on whether the market should be segmented by channel, given that no competition concerns are raised by this merger. The OFT notes that the parties do not appear to operate within the same channel, however on a cautious basis, the OFT has considered the impact of this merger taking both the civil and heavyside specialists and GBMs together, thus capturing both the parties in its assessment.

⁸ *Saint Gobain/Build Center*, paragraph 24.

⁹ OFT CC Joint Merger Assessment Guidelines, paragraph 5.2.2

Segmentation by customer type

16. The OFT considered whether or not to segment the market on the basis of the size and character of customers. In previous cases in the building materials sector, the OFT has found that larger customers may demand national or regional coverage, or may demand credit terms or prices that local independent merchants are not able to offer. For example, the OFT has found it appropriate to define separate customer segments in *Jewson/Build Center*,¹⁰ and *Edmundson/Electric Center*.¹¹
17. Tunnel supplies to civil and heavyside customers, therefore the OFT has focused on this group of customers. The parties submit that due to the characteristics of civil and heavyside customers, and the products that they buy, purchases are large and uniform (both in terms of value and physical size) such that segmentation is not appropriate. In support of this, despite some customers having framework agreements for supply of products, none of these customers expressed a belief that their contacts can only be served by a subset of the market.
18. The OFT's market investigation indicates that civil and heavyside customers are generally larger customers with a nationwide presence who are more likely to purchase goods through framework agreements or other long term contracts, and which may specify certain levels of geographic coverage, thereby limiting the number of competitors for this type of customer. These factors may indicate that smaller independent or regional merchants may not be able to serve the requirements of certain large civil and heavyside customers. In practice, the OFT's investigation indicates that only the largest GBMs with nationwide presence are able to supply these customers.
19. In support of segmenting the market for civil and heavyside customers there are few companies active in this sector who offer similar products and services. One GBM indicated that there are, 'few serious players in below ground drainage with few if any other small independent players.' Given that no competition concerns arise on any basis, it has not been necessary for the OFT to conclude, although the OFT takes as the basis of its assessment civil and heavyside customers.

¹⁰ Paragraph 24.

¹¹ Completed acquisition by Edmundson Electrical Limited of Electric Center, OFT decision of 23 July 2012. Paragraphs 24 to 32.

Conclusion on product scope

20. Given that ultimately the OFTs conclusion is that no substantial lessening of competition arises from this transaction regardless of whether the market is segmented according to product offerings, retail channel or customer types, it has not been necessary to conclude on product market definition in this case. On a cautious basis, the OFT has assessed this merger on the basis of the supply of drainage products to civil and heavyside customers by either GBMs or civil and heavyside merchants.

Geographic scope

21. The parties submit that the geographic market is likely to be national for several reasons.
22. They submit that each of Tunnel and WUK (Drain Center) has been established to supply products to civil engineering, utilities and construction professionals on a national basis. Individual branches are not focused on spot sales and do not tend to have significant numbers of customers visiting branches in person. On average, WUK estimates that only [less than 25] customers visit each Drain Center each day. [], [] per cent of sales by the Relevant Branches are delivered to customers and manufacturers deliver [] per cent of sales of the Relevant Branches direct to customers.
23. The parties have a number of national or framework contracts, [] of which represented 35 per cent of Tunnel's sales in its last financial year and are concluded by the head office sales office or key account staff at branches. Both Tunnel and Drain Center determine their price, quality, range and service for products nationally and every national, framework, or key account customer will negotiate its own terms that are applied to the national list prices. For a national or framework contract, the terms (applied on a national basis) are set by head office.
24. Manufacturers compete directly with distributors and they do not have any significant local distribution networks, choosing to deliver nationally, direct from production plants. For example, [].

25. Notwithstanding WUK's arguments, the OFT believe that certain parameters of competition may vary locally,¹² and given that goods are delivered at least in part from local depots, the price for some customers (particularly those that may acquire less specialist products from the parties such as above ground drainage, below ground drainage, access covers and gratings, construction products, surface drainage and safety and protective equipment) may be based on the degree of local competition. The parties have provided data on the percentage of goods collected, and delivered by them, on the one hand, and those supplied directly by the manufacturer, when ordered in branch, on the other hand. This shows that on average [less than 30] per cent of goods for Burdens were collected,¹³ suggesting that the delivery catchment area is likely to be a reasonable approximation of the area over which they compete.
26. The OFT has previously decided that in cases where there are multiple local areas, catchment areas provide a pragmatic approximation for a candidate market. The OFT has generally defined this catchment area to include the area over which the large majority of customers (generally 80 per cent) are located.
27. WUK has provided the 80 per cent delivery catchment area for each of the Relevant Branches. Based on this analysis, the OFT notes that the average distance travelled for delivery of all types of products is just over 30 miles.
28. However, as no competition concerns arise on any plausible geographic market definition, the OFT has not needed to conclude as to whether the market is national or local (or the size of the relevant catchment area), although it has looked at both these parameters as part of its assessment on a cautious basis.

¹² The OFT has not been provided with any survey data in this case, with which it can assess customer preferences in this sector. However, the OFT has previously found that customer relationships with the branch staff are important in the GBM sector. Third party responses suggest that factors that vary locally, such as the relationship with a merchant or the merchant being situated in a convenient location, are important.

¹³ In contrast [over 30] per cent of goods are collected at Drain Center, as explained later, this is reflective of the different products sold by Drain Center, which make it a distant competitor to Burdens.

Conclusion on geographic and product market

29. The OFT has assessed the transaction against a market for drainage products for civil and heavyside customers, which it has taken as those firms supplying products to civil, engineering, utilities and construction customers. As competition concerns do not arise under any plausible geographic market definition, the OFT has not had to conclude but has cautiously looked at both the national and local parameters of competition.

HORIZONTAL ISSUES

Market Shares

30. WUK has estimated its own and competitors' market shares based on management estimates and industry knowledge, as no independent data source exists.
31. WUK estimates that the parties have a combined national share of supply of around [10 to 15] per cent if manufacturers are included in the share of supply figures.
32. The OFT's investigation indicated that manufactures may exert some competitive constraint on civil and heavyside merchants in this sector as [below 50] per cent¹⁴ of Burden's deliveries are made directly by the manufacturer. The parties have indicated that there are two different types of order which will be delivered by the manufacturer rather than the merchant. The first is large orders which are placed by a customer with a merchant, where the price is set through negotiations with the merchant, but are fulfilled directly by the manufacturer as the volume is sufficient to warrant direct delivery rather than transiting goods through a depot. The second is where a large customer negotiates the price directly with the manufacturer, typically under a framework agreement, which then fulfils the order. The OFT considers that manufacturers may be able to exert some constraint on merchants to the degree that customers in the first group would be able to switch to negotiating prices directly with the manufacturer.
33. However, the OFT has not been provided with any evidence as to the extent that customers would switch from negotiating a price with the

¹⁴ Response to Additional OFT questions part 1

merchant to negotiating directly with the manufacturer. As such, taking a cautious approach, the OFT has also calculated shares of supply without taking into account the supply from manufacturers. This has enabled the OFT to obtain a conservative estimate of the parties' share of merchant supply of civil and heavyside products. The OFT estimates that the parties' market share would increase to around [15 to 25] per cent if supply from manufacturers was disregarded.

34. This is not at a level which would typically raise prima facie competition concerns, unless the two parties are unusually close competitors, either nationally or locally. The OFT has therefore assessed the extent of closeness of competition between the parties.

Closeness of competition

35. WUK submit that WUK and Burdens are not close competitors.
36. WUK have stated that there is not a significant overlap between the two parties as they supply different types of products, and even where they supply products within the same broad category,¹⁵ they are not substitutable and have different logistical requirements. As a result, they submit that even though the firms may lie in the same broad product market, there is little if any competitive interaction between them.
37. WUK has provided a breakdown of the Relevant Branches' and Drain Center's turnover by product category.¹⁶ The data shows that the Relevant Branches generated around [25 to 35] per cent of their turnover from hard landscaping and construction products which are not sold by WUK, and Drain Center generated [40 to 50] per cent of its revenue from above ground drainage products, compared to only [0 to five] per cent for the Relevant Branches. The only categories with any significant sales overlaps are below ground drainage and pressure pipelines;¹⁷ [25 to 35] per cent of

¹⁵ For example 1000mm (1m) diameter ductile iron water pipe (which accounts for [0 to five] per cent of Burdens below ground drainage sales) is in the below ground drainage category, as is 22mm diameter Hep20 pipe (which accounts for [0 to five] per cent of Drain Center's sales).

¹⁶ The parties provided their respective proportions of sales in the following products categories: above ground and below ground drainage, construction chemicals, construction products, environmental products, frames and cisterns, hard landscaping, mca, metering, pressure pipelines, safety and protective equipment and surface drainage.

¹⁷ The parties did not significantly overlap in any of the other product categories identified and these each accounted for less than 10 per cent of each of their turnovers.

WUK's turnover and [20 to 30] per cent of Burdens' (taken as a proxy for the Relevant Branches) turnover is accounted for by below ground drainage; [five to 15] per cent of Drain Centres' and [0 to five] per cent of Burdens' turnover is accounted for by pressure pipelines.

38. WUK submit that there are differences in the structure of the two businesses, such that Drain Center is unable to handle large products, which are commonly sold by Burdens. These differences are shown in information WUK submitted on the size of the Burdens and Drain Center branches in six areas selected by the OFT.¹⁸ The data indicates that there are significant differences in size of branches for Burdens and Drain Center, with Burdens' warehouses typically around 1.5 times the size of Drain Center's and Burdens' yard typically 24 times the size of Drain Center's. As a result Drain Center is unable to store large products, which are held in a yard rather than a warehouse.
39. Drain Center and Burdens also have a substantially different vehicle fleet, with Burdens operating mostly 26 tonne trucks, and multiple forklifts, and Drain Center operating either long wheel base vans or 7.5 tonne trucks and single forklifts. A competitor indicated that although some drainage can be delivered on smaller vehicles, civil and heavyside merchants typically need to operate 26-tonne lorries, with an attached crane. As a result Drain Center will, in most cases, be unable to deliver the large below ground drainage products.¹⁹
40. Product category level sales data, coupled with information on physical characteristics of branches, suggests that the two parties are not close competitors. However, such data is not capable of showing whether the same customers are purchasing from both suppliers, and as such may view them as substitutes. In merchanting markets the OFT has previously found evidence of multi-sourcing, with customers typically holding a number of accounts with different merchants for a host of different reasons. Although no survey data is available in this case, the OFT sent third party questions to around 300 customers of the parties, receiving 25 responses. Of the 25 respondents only three used a single supplier and 18 used three or more

¹⁸ These branches were selected as they generated a similar percentage of their total turnover from below ground drainage and/or pressure pipelines.

¹⁹ The OFT has confirmed that Drain Center do not operate larger vehicles in any areas which would fail a local filter.

suppliers, which is consistent with the multi-sourcing seen in other merchanting markets.

41. The OFT requested local level sales data for each account customer of Burdens and Drain Center, for May 2012, to see what percentage of spending was by customers who used both Drain Center and Burdens.
42. Based on 80 per cent delivery catchment area for each Relevant Branch the most potentially problematic area is Sheffield, where the merger may represent a three to two reduction in fascia. It does not appear, however, that the parties compete in this area as sales data indicates that customers are overwhelmingly not buying from both of the parties, as might be expected if they were competing with one another.²⁰
43. No large customer contacted by the OFT raised concerns about the merger, with the majority of customers indicating that the parties are not close competitors, a view also supported by the companies who the OFT contacted as perceived competitors. Additionally, the OFT sent out over 300 questionnaires to smaller customers, again with no customer raising any concerns, and the majority stating that they do not believe that the parties are close competitors.
44. On the basis of the evidence set out above, the OFT considers that there is little, if any, overlap between the parties and that there will not be a significant loss of competition resulting from the merger on a national or local basis. In summary, the OFT does not consider that the transaction will give rise to a realistic prospect of an SLC.

THIRD PARTY VIEWS

45. Where relevant, third party comments have been incorporated above.

ASSESSMENT

46. The parties overlap in the supply of drainage products to civil, engineering, utilities and construction customers in the UK through Burdens and Drain Center (which is a subsidiary of WUK).

²⁰ In May 2012, account customers spent a total of £[] in Burdens and £[] in Drain Center, both in Sheffield. However, only three customers, out of a total of 286 made purchases in both Drain Center and Burdens, accounting for only £2,000 of revenue ([]). Therefore, Drain Center and Burdens cannot be considered to be competitors in this area.

47. The OFT has not found it necessary to conclude on product scope in this case as no competition concerns arise under any plausible market definition, although it has analysed that transaction against a market for supply of drainage products to civil and heavyside customers by either civil and heavyside specialists or GBMs.
48. The OFT has assessed the transaction on a national and local basis but has left open the precise geographic market definition, as no competition concerns arise on any plausible geographic market definition.
49. The parties have a combined national market share of the civil and heavyside market of around [15 to 25] per cent, based on their own internal estimates and excluding supply by manufacturers. In addition, the evidence suggests that the parties are not close competitors, with little if any competitive interaction between them and very limited individual product overlaps. Drain Center branches are substantially smaller than Burdens, with smaller vehicles, both of which limit their ability to handle large and heavy goods. Data on customer account spending confirms that even in areas where there are few other merchants active in the supply of products to civil and heavyside customers, the parties do not share common customers which in an industry characterised by high levels of multi-sourcing can be viewed as strongly indicative of the parties not competing.
50. No customers have raised any concerns about the merger, with the majority indicating that they do not perceive the parties as being close competitors or indeed competitors at all.
51. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

52. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.