Completed acquisition by VPS Holdings Limited of SitexOrbis Holdings Limited

ME/5258/11

The OFT's decision on reference under section 22(1) given on 5 March 2012. Full text of decision published 5 April 2012.

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. **VPS Holdings Limited** (VPS) is the holding company for the VPS group of companies, which manage service solutions for vacant properties in the UK, US, France, Italy and Germany. VPS is ultimately controlled by TDR Capital LLP, a private equity fund manager.[1] VPS had worldwide group turnover in the year ending 31 March 2011 of £139.7 million, and UK turnover of £33.9 million. In the UK, VPS operated in the relevant business sector as Safe Estates until re-branding as VPS in March 2011.

2. **SitexOrbis Holdings Limited** (SO) is the holding company for a group of companies providing integrated property and people security services in the UK and other European countries. SO had worldwide turnover for the year to end March 2011 of £49.6 million, and a UK and Ireland turnover of £30.7 million.

[1] www.tdrcapital.com/vps-holdings.html

TRANSACTION

3. VPS acquired the entire issued share capital of SO on 27 September 2011 for a total consideration of £[ ] million.

4. The acquisition was structured as two separate sale and purchase agreements. The Continental European subsidiaries of SO were acquired in a separate transaction to the UK group. The consideration under the UK sale and purchase agreement comprised [ ].

5. The OFT accepted the parties' submission as satisfactory as of 4 November 2011. The extended administrative target deadline for a decision was 6 February, and the extended statutory deadline is 5 March 2012.

JURISDICTION

6. SO's turnover in the UK and Ireland in the year ended 31 March 2011 was £30.7 million, so the turnover test in the Enterprise Act 2002 (the Act) is not met.

7. The parties submitted that there are no independent estimates of shares of the total size of the vacant property services market, either by volume or value. The parties, however, submitted that 'it is possible that the share of supply test may be satisfied for physical security services for vacant properties'.

8. The OFT has been provided with information by both the parties and third parties which indicates that the parties will account for a share in excess of 25 per cent of the supply of vacant property security services.

9. The parties provided information in the form of the [ ][2] which estimated that for 2008 'The overall market size for secured vacant properties in Social Housing in the UK is [ ], of which [ ] are secured by steel or alarm.' This was considered to represent an 'estimated addressable market' worth some £[ ] million. The parties' submitted,

[2] [ ]. Submission 20 January 2012, Annex 8.

in 2011, that VPS services [ ] vacant social housing properties, and SO [ ]. Against a 2008 base of [ ] secured properties[3] this would represent shares of [25-35] per cent and [30-40] per cent respectively in the supply of vacant property security services to social housing customers. The OFT notes that allowing for the steady decline in the levels of vacant housing stock since 2008 would imply that the parties' current combined share of supply may be even higher.

10. It therefore appears that the share of supply test under section 23 of the Act is or may be met in relation to the supply of vacant property security services to the social housing sector in the UK. On the basis of the figures provided to the OFT (see paragraph 51 below), the share of supply test would also be met in respect of the supply of vacant property security services to the commercial property sector.

MARKET DEFINITION

11. 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 the merger in a mechanistic way. In assessing whether a merger may give rise to an substantial lessening of competition (SLC) the OFT may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[4]

12. The parties note various previous mergers in the facilities management and the security services sectors which have been examined by the OFT, the Competition Commission (CC) and the European Commission (EC). Examples in security services include: Securitas/ Reliance Security Services/ Reliance Security Services Scotland (EC);[5] Group 4 Falck/Securicor (EC);[6] Securitas/Chubb Security Personnel (OFT);[7] and Group 4/Wackenhut (CC).[8] These

[3] Out of an estimated total of [ ] vacant social housing properties.

[4] CC/OFT Merger Assessment Guidelines, paragraph 5.2.2.

[5] Case No COMP/M.5993

[6] Case No COMP/M.3396

[7] ME/4863/11

cases considered overlaps in areas, such as, static and mobile manned guarding, alarm monitoring and response, electronic guarding equipment. The OFT notes that these areas are not directly relevant to its assessment of this merger which relates the provision of vacant property services.

Relevant markets

13. The parties overlap in the supply of vacant property services.[9] These services are designed to keep vacant properties both secure and in suitable condition to be re-occupied at short notice. The parties have extensive operations across the United Kingdom with SO operating from 25 depots[10] across the UK and VPS operating from 23.[11]

14. There are a wide range of services included within the supply of vacant property services.[12] In broad terms, these comprise:

    (a) physical security (steel or polymer screens, steel doors, key management services, manned guarding)
    (b) specialised alarms (including alarm response services)
    (c) clean and clear services,[13] and
    (d) facilities services (fencing/bollards, repairs, transfer of utility services).

15. Within the overall sector for securing vacant property, a distinct set of services is supplied consisting of the rental (typically, on a weekly

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[8] Group 4 Falck A/S (G4F) and The Wackenhut Corporation a report on the merger situation, October 2002.
[9] The word 'vacant' is interchangeable with the term 'void' which is used by some parties.
[10] The depots are located in Dartford, North London, Southward, Brighton, Hook, Rainham, Bristol, Cardiff, Blaenau Gwent, Govan, Kirkcaldy, Edinburgh, Greenock, Belfast, Birmingham, Walsall, Nottingham, St Helens, Heywood, Salford, Seaham, Middlesborough, Bradford, Sheffield and Hull.
[11] Its depots are located in Carlisle, Kilmarnock, Bradford, Hull, Leeds, Stockton, Liverpool, Rochdale, Wirral, Corby, Crewe, Dinnington, Mansfield, Nottingham, Bridgend, Bristol, Cardiff, Birmingham, Deptford, Portsmouth, Watford and Salford.
[12] The parties submitted these broad descriptions. Informal Submission 4 October 2011 paragraph 4.3
[13] This can include changing and removing fittings, clearing rubbish, making general repairs, shutting down utilities, and cleaning up after squatters or trespassers.

basis), and installation of steel screens, alarms, and doors. This security apparatus is generally fitted and removed by the supplier at the beginning and end of any rental period. Products may also be sold on a 'fit and forget' basis in relation to demolition properties,[14] while the parties also indicated that some social housing customers purchase products in order to self-supply. These services are referred to as 'vacant property security services' throughout this decision.

16. The OFT's investigation shows that there are two distinct customer groupings who require vacant property security services; social housing and commercial customers.

17. **Social housing customers** include local authorities, intermediaries, and other 'registered social landlords' (including housing associations, trusts and co-operatives). These customers purchase vacant property services through two principal means: contract tenders, and on a 'quote and order' basis, as required. In relation to contract tenders, social housing customers utilise public sector framework arrangements set-up by organisations, such as, Fusion21 and LHC to procure services which meet the public procurement rules. These framework agreements set out detailed supply terms which are then incorporated into an individual supplier agreement or form the basis of a mini-tender amongst approved framework agreement suppliers. Intermediaries, such as, Keir, Morrison and Mitie, contract with local authorities to supply property and facilities management services and then subcontract to firms, such as the parties, for vacant property security services.

18. **Commercial customers** range from supermarkets, pub companies, insurance companies, retail outlets to a range of other businesses. These commercial customers purchase vacant property security services through a variety of methods including contract, 'quote and order', and preferred supplier contracts.

[14] This refers to the products being left on the building and is demolished along with the building

Product scope

19. The parties submit that the relevant product market for an assessment of this merger is that for the supply of integrated vacant property services, because customers generally purchase 'a tailor made range of alternative and complementary products and services for properties'. They submitted that this comprises:

    (a) security services, which include:

    i. proactive security (including lock changes, inspections and net curtains, manned guarding and live-in guarding and first response services)
    ii. physical security (including steel/wood/polymer screens and doors, electronic key management services and CCTV/remote monitoring), and
    iii. alarms

    (b) clean and clear services (including cleaning and clearing waste, room strip-outs, decontamination service and specialist cleans, and

    (c) facilities services (including fencing and bollards, disconnection of utility services, demolition or repair).

20. The parties submit, in the alternative, that even if the market is drawn more narrowly, the constraints from these wider set of alternative vacant property services are significant.

21. The OFT generally uses the hypothetical monopolist test as a tool to ensure that the relevant product scope is not drawn too narrowly.[15] In assessing whether a price rise will be profitable the OFT will take into account a range of evidence including information about product characteristics, information about relative price levels, responses from customers and competitors and internal documents.

22. The OFT has considered whether, as the parties suggest, the entire range of vacant property services should be regarded as a single

[15] OFT/CC Merger Assessment Guidelines, paragraph 5.2.10 – 5.2.16.

market. However, its investigation has not supported this conclusion. The parties' internal documents including reports commissioned by them on business opportunities make a clear distinction between 'security services' and 'property services'. For example, [ ].[16] The evidence provided by the parties also refers to the [ ] – which would suggest different constraints on the supply of these services - such that a shift in product mix due to increased sales of these other services in 2011 had negatively affected SO's overall average gross margin.[17] In addition, other materials point to SO as operating in a [ ].[18]

23. Generally, the vast majority of services supplied by the parties meet specific different customer requirements. The lack of any direct substitution between physical security services and facilities management services has been largely supported by third party responses from customers and competitors. The way in which services are supplied also supports a distinction in terms of product scope given that there is a significant degree of sub-contracting which takes place with respect to different elements of vacant property services.

Demand side alternatives

24. The relevant product market is identified primarily by considering the response of the customers to an increase in the price of one of the products of the merger firms.[19] The OFT considers a wide range of evidence in seeking to identify the appropriate product scope including product characteristics, relative price levels, third party responses and internal documents. The core overlap between the parties is in the supply of vacant property security services – that is, the supply of metal screens, permascreens, security doors, polymer screens and GSM alarms. The parties submit that customers will have 'plenty of alternative reasonably priced solutions to constrain any attempts by them to raise prices for, inter alia, steel and alarms

[16] [ ]. Submission 20 January 2012, Annex 14.
[17] [ ]. Submission 4 November 2011, Annex 3.
[18] Information Memorandum [ ]. Submission 20 January 2012, Annex 16.
[19] CC/OFT Merger Assessment Guidelines, paragraph 5.2.7.

after the merger.' Demand-side substitutes put forward by the parties include:

(a) alternative physical security products (for example, wooden boarding)

(b) self-supply (switching to in-house provision)

(c) alternative vacant property security solutions such as CCTV, manned guarding, inspections and live-in guardians.

25. The OFT has considered each of these areas in turn. Information submitted by the parties, in the form of the [ ] indicates,[20] in relation to social housing security services, [ ].

Alternative products/boarding

26. One third party submitted that wooden boarding is not typically a suitable alternative to steel for those areas where property security is considered a risk. Another third party suggested that in some circumstances wooden boarding may be applied initially as an emergency measure until steel could be applied.

27. The OFT considers that whilst the parties have submitted some examples of switching by customers to alternative security solutions, they did not provide compelling evidence that the hypothetical monopolist test would not be met for the core products in the parties' vacant property security offering, as mentioned at paragraph 24 above.

Self supply

28. The parties have presented some evidence of self supply in the social sector (three local authorities out of 145). However, the OFT has not been presented with sufficiently compelling evidence that self-supply (or the threat of self-supply) poses an immediate constraint on the parties' pricing behaviour in any way or, for that

[20] VPS [ ]. Submission 20 January 2012, Annex 8.

matter, would serve to protect local authorities that do not self supply.

Alternative security solutions

29. CCTV, manned guarding, inspections and live-in guardians are considered by the parties to be alternative security solutions. The OFT accepts that these sorts of activities provide a security solution for a customer, however, this is a different solution in terms of price and characteristic and service provision than that provided by the parties. The OFT also notes that, to the extent the parties provide such services, it is not part of their core business. In terms of the impact of these services on the parties' pricing behaviour, the OFT found no evidence that these alternative security solutions were used by customers as a means of constraining the prices or services offered by the parties when supplying vacant property security services in the form of steel screens, doors and alarms. Third parties were not inclined to switch to any of these alternatives.

Customer segmentation

30. The OFT may sometimes define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on others groups of customers, and require separate analysis.[21] The parties submit that it is not appropriate to segment between commercial (including, for example, pubs and retail outlets) and social housing channels, given basic similarities in the type of service provided and the products used, as well as the sales and marketing strategies used to attract each set of customers.

31. However, information provided by the parties differentiates between commercial and social housing clients in its assessment of business developments. Revenue per property protected, for example, [ ]. VPS data indicates an average weekly revenue of £[ ] for commercial properties, and £[ ] for social housing properties.[22]

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[21] CC/OFT Merger Assessment Guidelines, paragraph 5.2.28

[22] [ ]. Submission 20 January 2012, Annex 25.

32. Some third parties perceived each of the parties as having historically been focused on different segments – VPS on commercial property and SO on social housing. The fact that SO was not active in the commercial sector, until [ ], indicates that competitor sets may vary between the customer segments.

33. The OFT considers that there are strong grounds for segmentation of markets by type of customer in this case. That being so, the OFT also recognises that certain assets can be used for the purposes of both the commercial and social housing aspects of the parties' businesses, and that SO's entry into the commercial segment may have been facilitated by its existing social housing business and depot network. One third party stated that commercial property offers higher profit opportunities but only where overheads are covered by the social housing [depot] infrastructure.

Conclusion on product scope

34. On balance the OFT, as a first phase authority, takes a cautious approach to market definition. In this case the evidence suggests that the parties compete primarily in the narrow market for the supply of vacant property security services. There is, however, support for segmenting the market between social housing and commercial customers.

Geographic scope

35. The parties service contracts using their extensive depot networks, and are well-placed to serve demand requirements in most parts of the United Kingdom, from their existing infrastructure.

36. The parties did not submit a specific view on the appropriate geographic market. The parties submit that, in practice, most of their customers are close to the depot from which they are supplied. However, it is the case, they contend, that vacant properties can be and are readily served over considerable distances from any given depot. One third party stated that it operates within a radius of about 120 miles from each of its two depots. The parties submitted that depots are opened and closed on a fairly regular basis as

contracts are won or end, such that expansion from one region to another can occur relatively easily.

Social housing customers

37. The parties noted that contracts with social housing customers are generally restricted to a property estate within a local or regional area. They suggested it was not unusual for them to win a contract and then establish a depot in the area from which to serve that customer and then expand within the area from that base. They did refer to national contracts for social housing property services for which large facilities management companies (such as Kier, Morrison, Mears, Mitie) subcontract out the vacant property service elements on a regional basis. In addition, there are national framework agreements which facilitate purchasing by public bodies from appointed pre-approved providers. The criteria for appointment to framework agreements, such as that operated by LHC[23] and Fusion21, include scope of geographic coverage in GB as an important element. As such, a proportion of local authorities may procure through national framework contracts for local service provision.

Commercial customers

38. The OFT considers that, on the basis of the available evidence provided, demand for vacant property security services in the commercial property sector may be for either a national estate of properties or for more localised provision. The majority of customers which submitted comments stated that their requirements were national and required a supplier with a certain geographic scope as demonstrated by service offers or depot infrastructure. That said, a few considered that services were supplied locally or regionally.

Conclusion on geographic scope

39. The OFT has not undertaken a local or regional depot-level overlap analysis. The OFT considers that it is reasonable to conclude that the

[23] See www.lhc.gov.uk/Frameworks-Directory/Void-Property-Protection-Estate-Management

market has some national and regional/local features depending on the nature of the customer. The OFT has, therefore, focused its assessment on the positions of the parties and their competitors with respect to a national geographic scope for both social housing and commercial customer segments. However, the OFT recognises that there may also be regional or local aspects to competition for a significant group of customer requirements, and does not exclude that there may also be relevant regional or local markets.

Conclusion on market definition

40. Based on the above assessment, the OFT has taken a cautious approach and considers the appropriate frames of reference for its assessment of this transaction are:

    i. vacant property security services for social housing customers in the UK, and
    ii. vacant property security services for commercial customers in the UK.

HORIZONTAL ISSUES

Counterfactual

41. In reviewing mergers, the OFT is required to assess whether the merger creates a realistic prospect of a substantial lessening of competition. The 'is or may be the case' standard in the OFT's reference test also has implications for its approach to the counterfactual. The OFT considers the effect of the merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In practice, the OFT generally adopts the prevailing conditions of competition (or the pre-merger situation in the case of completed mergers) as the counterfactual against which to assess the impact of the merger.[24]

42. The parties submit that [ ].

43. The OFT understands that [ ].

[24] OFT/CC Merger Assessment Guidelines, paragraph 4.3.5.

44. However, the OFT has seen no evidence to suggest that [ ].[25] Therefore, the OFT considers, on the basis of the evidence available to it, that the pre-merger situation is the best indicator of the counterfactual in this case.

UNILATERAL EFFECTS

45. The OFT considers the principal theory of harm to be unilateral effects, including the loss of existing and potential competition. As part of this assessment we have considered market shares, closeness of competition, bidding data and profit margins before then considering any wider constraints, barriers to entry and expansion and buyer power.

Market shares

46. When interpreting information on market shares and concentration the OFT may have regard to how widely the market is drawn.[26] A low combined market share on the narrowest market that satisfies the hypothetical monopolist test will be a better indicator of an absence of potential competition concerns than the same share on a market that is drawn more widely.

47. Evidence provided by the parties (including as reflected in Table 1, which was prepared for SO in 2010), supported by third party comment, indicates that the parties are the leading specialist providers of vacant property security services in the social housing and commercial sectors.

Table 1 - Competitive positioning,[27] [ ].

Competitor group	Competitive advantage	Main constituents
Social housing	[ ]	[ ]
Commercial	[ ]	[ ]

48. Turnover data for the leading specialist vacant property security services providers, indicates that the parties are each several times

[25] The Response at paragraph 5.5(d). Submission 20 January 2012, Annex B.
[26] OFT/CC Merger Assessment Guidelines, paragraph 5.3.2.
[27] Information Memorandum [ ]. Submission 20 January 2012, Annex 16.

larger than SPS Doorguard and Clearway – two companies broadly regarded as the next tier, by size, of specialists (after the parties)[28] – in terms of both UK revenues and available data on numbers of properties secured. Several other smaller companies regarded by the parties as 'national' have turnover in the £0-2 million range.

Table 2 - Specialist vacant property security suppliers

	Properties secured (approx.)	**UK Turnover**
Leaders		
VPS	[ ]	£34m
SitexOrbis	[ ]	£31m
SPS Doorguard	n/a	£6m
Clearway	[ ]	£4m
Others		
SecureSite UK	n/a	£1-2m
Pro-tex	[ ]	£[ ]m

Source: Public data, the parties and third parties.

49. The parties service approximately [ ] properties – [ ] social housing; [ ] commercial. This is a 'stock' figure,[29] rather than the number of different properties serviced during a year, since there will be significant churn in properties secured both within and between customer supply relationships during the course of a year.

50. On the basis of the evidence provided (see paragraph 9 above)[30] the OFT notes that VPS services [ ] vacant social housing properties, and SO [ ]. Against a 2008 base of [ ] secured properties[31] this would represent shares of [25-35] per cent and [30-40] per cent respectively in social housing leading to a combined post-merger share of [60-70] per cent. The OFT notes that these market share figures may be an underestimate. This is because there has been a steady decline in vacant housing stock in the past four years. As

[28] Information Memorandum [ ]. Submission 20 January 2012, Annex 16.
[29] The is the average number of properties secured at any one time.
[30] [ ]. Submission 20 January 2012, Annex 8.
[31] Out of an estimated total of [ ] vacant social housing properties.

such, the present combined share of supply may be higher than these figures.

Table 3: Revenues by customer segment.

	Social Housing	Commercial	Other	Total
VPS (2010/11)	£[ ]m	£[ ]m	-	£33.9m
SO (2011)	£[ ]m	£[ ]m	£[ ]m	£30.7m

Source: The parties.

Table 4: Vacant properties serviced by customer segment.

	Social Housing	Commercial	Total
VPS	[ ]	[ ]	[ ]
SO	[ ]	[ ]	[ ]

Source: The parties.

51. The [ ] also provided an estimated market size for 'vacant commercial property security services' in 2008 of [ ] properties. This was considered to represent an 'estimated addressable market' value worth £[ ] million. However, the proportion using steel and/or alarms was estimated to be only around [ ].[32] Even allowing for market expansion estimated to be at [five-10] per cent a year[33] – on the figures above the parties' share of physical security (excluding plywood) for vacant commercial properties could again be high, at least [75-85] per cent.

Closeness of competition

52. The parties acknowledge that they are considered to be each other's closest rivals with regard to physical security products for void properties, with complementary strengths. They overlap in both the commercial and social housing sectors, although their respective current positions within each vary in terms of revenues and property numbers, as shown in Tables 3 and 4 above.

53. The OFT has considered the parties' internal documents and publicly available materials in order to determine the competitive landscape

[32] VPS [ ]. Submission 20 January 2012, Annex 8.
[33] [ ]. Submission 20 January 2012, Annex 8.

the parties operated in prior to the merger. SO describes itself as, 'the UK market leader for integrated empty property solutions and people protection'.[34] VPS claims that, 'VPS are the trusted specialists in securing, maintaining and managing vacant properties across a wide range of customer and industry sectors the world over.'[35]

54. The parties submit that the market offers 'a spectrum of competitively priced alternatives which customers can use', and that customers have the ability to self-supply or switch to competitors.

55. However, the [ ][36] [ ][37]. In addition evidence provided,[38] [ ].

56. Most third parties referred to VPS and SO as the leading suppliers of rental services for vacant property security equipment in the UK. They viewed the parties as close competitors, particularly with respect to the provision of security equipment such as steel screens, doors and alarms. One third party raised the concern that the parties both benefit from owning a large volume of steel screen stock which has already been depreciated, and can therefore make submitting low quotes to win incremental business a viable strategy.

57. The OFT notes, in this regard, that its investigation shows that there is some evidence that each of the parties have certain cost advantages pre-merger consisting of steel screen stock and extensive depot networks established closer to customers than any rivals. This may have enabled them to deliver keen pre-merger pricing in close competition with each other that other rivals have generally not been able to match or compete with.

58. The OFT considers, on the basis of the evidence available to it, that the parties were the two largest providers of vacant property security services prior to the merger to both the social and commercial sectors. As noted above, third parties confirmed this and the extent to which their business models, costs and set-up showed

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[34] www.sitexorbis.co.uk
[35] www.vpspecialists.co.uk
[36] [ ]. Submission 20 January 2012, Annex 8.
[37] [ ]. Submission 20 January 2012, Annex 8.
[38] [ ]. Submission 20 January 2012, Annex 12.

that they were each other's closest competitors pre-merger. Following the merger, the OFT has concerns that the benefit of this close rivalry between the parties will be lost and has therefore assessed the extent to which constraints exist in the market which would replace this loss and thus continue to pass on the benefits of competition to both social housing and commercial customers.

Bidding data

59. The OFT also notes that the bidding data provided by the parties indicates that the parties win and lose business against each other on a regular basis. For social housing contracts, market participants may win business either through being appointed (along with others) to framework agreements, or by winning tenders for specific projects or customers. The parties [ ]. Evidence provided shows that for the two framework agreements, LHC and Fusion21, the parties were the only two providers that applied and were appointed to the relevant framework agreement for void property security services.

60. For concluded void security contract tenders in the past two years where both parties had submitted bids, all [ ] were won by one of the parties.[39] The parties internal documents[40] also indicate that SO and VPS offer a similar range of property services to their customers and will often compete for tenders in the social housing market.

61. The OFT considers it reasonable to infer, from the parties' appointments to the framework agreement, the scope and strength of their offer, both at a national and non-national level. Based on the evidence,[41] the OFT notes that whilst there is some inertia to switching in the social housing sector, VPS and SO would appear to be close competitors, with customers switching between them for better terms and conditions.

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[39] Response to request for further information, question 13. Submission 20 January 2012, Annex B.
[40] [ ]. Submission 4 November 2011, Annex 3.
[41] [ ]. Submission 20 January 2012, Annex 18.

Variable profit margins

62. The OFT considers that if the variable profit margins of the products of the merging firms are high, unilateral effects are more likely because the value of sales recaptured by the merged firm will be greater, making a price rise less costly.[42]

63. Management accounting data and other due diligence materials indicate gross margins for each party of the order of [40-50] per cent. Further, such materials indicate that SO's gross margins in 'steel and alarms' are about [50-60] per cent and therefore notably higher than the average across the parties' wider product portfolios.

64. The parties submit that their **variable** profit margins are rather lower, of the order of [20-30] per cent taking into account categories of costs 'which are variable over a 1-2 year period and change with the size of the business', including labour, capital investment and depot costs.

65. The OFT has not carried out a detailed analysis of direct cost identification, but queries whether incremental business serviced from existing infrastructure would necessarily incur direct costs in all of these categories. The OFT places some weight on the consistent focus on gross margins in the parties' business[43] and deal documents,[44] and considers that they may be consistent with relatively high variable profit margins for incremental business in this case. The OFT also considers that high gross margins may provide some evidence that price constraints from customer switching to alternative products may be limited (high variable margins being consistent with low demand elasticity).

Conclusion on unilateral effects

66. On the basis of the above evidence on estimated shares, closeness of competition, bidding data and gross margins, the OFT considers that the merger gives rise to a realistic prospect of a substantial

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[42] OFT/CC Merger Assessment Guidelines; paragraph 5.4.9
[43] For example, Submission of 20 January 2012, Annex 11, table at paragraph 901.
[44] For example, [ ]. Submission 4 November 2011, Annex 3.

lessening of competition in the supply of vacant property security services for each of social housing and commercial customers. The OFT now turns to assess whether there are any countervailing factors sufficient to outweigh the competition concerns identified in relation to this merger by reference to certain wider constraints, entry and expansion and buyer power.

Wider constraints

67. In assessing whether a merger may give rise to an SLC the OFT may take into account constraints outside the relevant product market.[45]

68. The parties submit that there are other wider constraints which limit the scope for the parties to raise price or otherwise worsen their offer. For example, boarding up with wood; manned guarding; and self supply (purchasing equipment and fitting it using own staff). The OFT addresses each of these proposed wider constraints in turn.

Boarding-up with wood

69. The OFT acknowledges that wooden boarding-up can be provided by a wider range of providers than would be identified as specialist vacant property services providers. As noted above, boarding is a cheaper option than metal security, however the OFT's investigation indicates that a number of customers seek steel sheets/doors for additional security this provides and are willing to pay a higher price for this. For these customers, boarding up is unlikely, based on the evidence available to the OFT, to be a sufficient alternative in the face of a post-merger price rise. The OFT notes that a third party commented that steel security is a niche market so clients will call out ordinary board up companies out of hours and then call for steel. This tends to indicate that they are complementary rather than direct substitutes for some customers. One of the 'key findings' reported by [ ][46] following customer interviews was that [ ]. Another third party commented that it would not be open to them to use other materials (over steel) as this is not as secure. In summary, therefore, the OFT does not consider that it has been provided with sufficiently

[45] CC/OFT Merger Assessment Guidelines paragraph 5.2.2
[46] [ ]. Submission 20 January 2012, Appendix 14.

compelling evidence that boarding up would constrain the parties' activities post-merger.

Manned guarding/live-in guardians

70. From the evidence provided to the OFT, manned guarding appears to be a complementary service rather than an alternative to the services supplied by the parties, that is, steel screens/doors and alarms. This is, in part, since the service involves an immediate response by the guard to an attempted break-in or vandalism. The OFT accepts, however, that demand can also vary according to changes in the balance between risk tolerance and security costs. One third party stated that greater use of residential caretaking services (guardians) would be an option but not, currently, a cost effective one. On balance, however, the OFT does not consider that it has been provided with sufficiently compelling evidence that manned guarding or live-in guardian options would constrain the parties' activities post-merger.

Advanced (so called, 'videofied') alarm systems

71. It was suggested that the more modern and advanced technology alarms – that are able to transmit a short burst of video to a central monitoring unit that can then decide whether a guard should be despatched – may replace the need for screens in some cases and over the long-term. However, the OFT was not provided with evidence of customers switching to videofied alarms as an alternative to, say, steel screens. The OFT was also not provided with evidence of the parties monitoring of the rise of technologically advanced alarm systems, which might be expected if they were to perceived to be a significant constraint over the medium to long-term.

Self-supply

72. The parties provided some examples of self supply in the social housing sector (see paragraph 86) but while this may prove an option for these authorities it is difficult to see how this provides any wider constraint on the parties.

73. Overall, it has not been established, to the necessary standard, that switching to other types of security products would necessarily prevent a profitable price increase by the merger parties.

Constraints from potential entry

74. In order for entry or expansion to prevent an SLC, such entry or expansion would need to be considered as timely, likely and sufficient in scope to deter or defeat any attempt by the merged party to exploit any lessening of competition resulting from the merger.

75. An Information Memorandum prepared [ ],[47] identified the following [ ][48]. [ ].

76. The parties submitted that the report prepared by [ ][49] included 'positive, subjective statements on the business and industry to [ ]'. They submit that barriers to entry are, in fact, extremely low, that the relevant staff skill base and technology requirements are low, and a potential entrant can obtain the necessary requirements (such as steel and alarms) without significant difficulty. They submit that few entry costs are sunk costs (not recoupable on exit).

77. From the information provided it is clear that for new entry there needs to be depot(s), stock of security equipment, on-site staff and a sales team and a management team capable of managing a wide range of small value contracts across multiple UK regions. The OFT notes that it may be relatively easy to satisfy a single contract for one commercial property or a small housing estate on the back of a small team of fitters and to buy-in stock as and when required. The parties provided certain evidence for this type of small scale entry. However, for entry to be sufficient, the OFT would expect the entry to counter the loss of rivalry brought about by the merger. In the case of the smallest of the parties, this would involve a depot network (or equivalent provision) of up to 23 depots and, on current

[47] [ ]. Submission 20 January 2012, Annex 16.
[48] The limited number of providers with required accreditations (e.g. CHAS) was identified by one third party as a source of difficulty in constructing an adequate tender shortlist.
[49] The Response. Submission 20 January 2012, Annex B

provision, a significant provision of steel stock, together with product development in terms of alarms and other associated products. The OFT considers that all these elements enable each of the parties to service large scale and volume contracts consisting, as they do, of the provision of relatively small value (in terms of rentals) individual components involving securing social housing and commercial properties across the UK. Against this background, the OFT considers therefore that it may be difficult for a new entrant to win large contracts or be accepted on framework agreements without an existing track record and experience or significant investment in depot, stock and infrastructure. The OFT notes that its investigation including some third parties largely confirmed this. For instance, in relation to the requirement for stock, although the parties put forward a significant amount of data intended to show that steel stock was not necessary in order to compete effectively in this market, the OFT notes that a third party commented that the parties had a large stock of fully depreciated materials such as screens, doors and alarms which they could bid at marginal cost. The OFT considers that, whilst it would be possible for a new entrant to operate on a basis of acquiring stock as and when needed, to replicate the scale of either of the parties may raise a barrier to entry. In addition, another third party stated that the barriers were quite significant for entry on a medium to large scale, as it involved the design of new cellular battery operated alarm, plus bespoke software to take orders and do the invoicing.

78. The evidence provided suggested that in relation to social housing security, a declining level of overall demand may tend to strengthen any barriers to entry by limiting achievable scale. The parties put forward that the rate of churn in the business infers that VPS has to win its current volume of work every [ ] months – which is a very high level of churn. This illustrates, the parties believe, the frequency with which opportunities to win new business arise for the parties and their competitors.[50] However, two third parties indicated that they had been contracting with the parties in excess of four years, and another said that they were a long-standing customer of SOs'.

[50] Informal Merger Notification dated 4 October 2011

New entry and expansion

79. The parties submitted that there has been new entry into the provision of vacant security property services and/or that existing competitors could expand to countervail and constrain the parties' post-merger. In particular, they submitted that two of VPS' ex-employees have recently founded a new vacant security services company – [ ]. On investigation, this company has no apparent live website or internet presence/marketing. Loxal Security was also identified as a recent entrant.

80. In terms of expansion, the parties also refer to SecureSite UK[51] acquiring the contract for Little Chef in 2007, which serviced 60-80 closed restaurants from two depots.[52] The OFT notes that both of these examples relate to the commercial sector and that they are limited in scale and scope. In addition, the position of Secure Site is reflected in the competition analysis above, that is, its presence as a competitor has been reflected in its ability to win business from the parties over time. In the period since 2007, it has not won substantial volumes of business from the parties as is shown by the parties' share of supply in the commercial and social housing sector. Other than these examples, the parties put forward limited evidence of actual new entry or expansion.

81. The parties also put forward that there is scope for entry from adjacent markets, such as, the large security companies. The OFT has, however, not been provided with any evidence that the large security companies have plans to enter this market. In fact, the large security companies ordinarily make use of preferred partner agreements whereby they sub-contract firms like the parties when tendering to provide security solutions to customers. For example, Clearway[53] has some supply arrangements with G4S, a major international security services company, and [ ].[54] It is not clear, however, to the OFT how any expansion of preferred supplier

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[51] www.securesiteuk.co.uk/leaflet-downloads/case-studies-2/boarding-up-case-study

[52] The Supplemental Response, paragraph 3.10, Annex A Submission 20 January 2012.

[53] The Supplemental Response, paragraph 4.19 and 4.21. Submission 20 January 2012, Annex A.

[54] The Supplemental Response, paragraph 6.2. Submission 20 January 2012, Annex A.

arrangements or the use of them could protect social housing customers or the entirety of commercial property customers for vacant security property services without full market entry by these large scale security companies into the space occupied by the parties.

82. The parties refer to the growth of SO's commercial property business as evidence of scope for entry and expansion. Up until [ ] SO only offered vacant property services to the social housing sector. The SO [ ][55] indicates SO was launching into the commercial sector and was intending to introduce a new sales initiative in the commercial sector with a target of [60-70] per cent of sales within [ ] years. Its annual commercial revenues increased from £[ ] million in 2010 to £[ ] million in 2011.[56] The OFT compares this with other information given by the parties including Clearway who entered the market to supply security services for vacant properties in 2004, according to the parties, and has seen its revenues rise from £[ ] million to £[ ] million in the last two years. The parties also assign [ ].[57]

83. The OFT notes that although SO has developed its commercial business only relatively recently, its similarity of offer is now closer to VPS and its geographic reach supported by its existing depot network (previously established for its social housing business). The OFT considers that SO's well-established vacant property security business and depot network maybe a strong base to extend its activities into vacant commercial property. It also considers that SO's reputation for focusing on customer service may have enhanced its entry abilities. The Information Memorandum [ ][58] states that for SO, [ ].

84. The OFT notes that the market has had some history of entry facilitated by mobile industry expertise. Basic technology and staffing requirements are relatively standard, although it is noted that

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[55] [ ]. Submission 20 January 2012, Annex 11.

[56] The Response, paragraph 5.5. Submission 20 January 2012, Annex B.

[57] The Supplemental Response, paragraph 4.19 and 5.13. Submission 20 January 2012, Annex A.

[58] Information Memorandum [ ]. Submission 20 January 2012, Annex 16.

some issues around accreditation requirements – both for staff and ISO quality management certification - are necessary.

85. On balance, taking into account the evidence available to it, the OFT considers it questionable whether entry (or expansion) of a scale sufficient to replicate the strong mutual constraint between the parties removed by the transaction would be timely and likely.

Buyer power

86. In some circumstances, an individual customer may be able to use its negotiating strength to limit the ability of a merged firm to raise prices. The OFT refers to this as countervailing buyer power. However, often only some—not all—customers of the merged firm possess countervailing buyer power. In such cases, the OFT assesses the extent to which the countervailing buyer power of these customers may be relied upon to protect all customers.

87. The parties submit that customers already have significant buyer power and are becoming more sophisticated purchasers of services (for example, through joint purchasing in the social sector). They submit that customers could sponsor new entry, but no concrete examples appeared to have occurred.

88. In relation to social housing customers, of the 145 local authorities in the UK, the OFT's investigation showed that a number do not currently use the LHC and Fusion21 national framework agreements to procure services. In any event, even if all 145 local authorities did so, there are a number of reasons why the presence of framework agreements do not indicate to the OFT, on the basis of the evidence available to it, that social housing customers, as a class, have sufficient buyer power to constrain the merged entity post merger. First, the criteria for the framework agreement is such that the parties are largely the only two suppliers capable of meeting the terms of entry and inclusion on the framework agreements and indicates that the framework agreement would need to change – this, in itself, may indicate a lessening of power for the framework agreement as a result of the merger. Second, the OFT received concerns as to the loss of negotiating strength as a result of the merger which would indicate that the choices available to them will

be restricted by the merger. Third, as noted above, the usage of these framework agreements is currently limited and for those local authorities and other social housing customers who, for whatever reason, do not use the framework agreements, they would not be protected through this mechanism, if it served to do so post-merger. The OFT also notes that the parties put forward certain arguments relating to self-supply of potential members of the LHC and Fusion21 national framework agreements, in particular, the parties refer to three examples of potential social housing customers[59] who purchased their own (security) equipment in order to save on rental costs, and have trained up their own staff to fit them. However, from the information submitted[60] it is apparent that social housing customers in general are reluctant to switch to in-house supply.

89. The OFT considers that it is also possible that the merger could remove pre-merger bargaining power such as the ability to have framework agreements including both parties but to run mini-tenders between them for specific requirements.

90. The parties submit that they also supply vacant property services indirectly to customers via significant intermediaries such as the large facilities management companies and security companies. They argue that such intermediaries actively shop around for sub-contractors, and that they would be able to switch to self supply relatively quickly and easily given their existing operations.

91. This assertion was supported, to some extent, by two examples of commercial businesses switching suppliers or between different types of security solutions. The [ ].[61]

92. There was some support for the parties' position on the potential for self supply from two third party intermediaries. However, another third party indicated that self-supply was unlikely to result in a satisfactory solution due to the need to provide for regular inspections, and another indicated that because of their businesses' geographic spread it was impractical.

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[59] [ ].
[60] [ ]. Submission 20 January 2012, Annex 18.
[61] The Supplemental Response, paragraph 5.17. Submission 20 January 2012, Annex A.

93. On balance, the OFT considers that existing buyer power is unlikely to exert a significant competitive constraint on the merged entity. There are some large customers who are able to exert buyer power and to play off the parties, which may be lost by the merger. However, a number of customers still expressed concerns regarding loss of competition post merger and the OFT has not been provided with evidence as to how buyer power would protect all customers.

Coordinated effects

94. No direct concerns have been raised about pre-existing coordination or the impact of the merger on the likelihood of coordinated effects.

VERTICAL ISSUES

95. No specific vertical issues or concerns have been raised.

EFFICIENCIES

96. While mergers can harm competition, they can also give rise to efficiencies. The parties submit that the acquisition will lead to material cost savings and other improvements that will provide customer benefits likely to offset any SLC. The merged entity will eliminate duplication of resources (in particular [ ]) and centralise management functions. The parties have not attempted to quantify efficiency savings that would reduce marginal costs (and hence be more likely to be passed on to consumers) as part of their submissions.

97. The OFT notes that synergies from [ ] would appear more relevant to reducing fixed costs. From the information the parties submitted[62] [ ]. Moreover, even if such synergies were to be realised it is not clear whether, post merger, there would be any incentive to pass through such benefits to customers.

[62] [ ]. Submission 4 November 2011, Annex 3.

THIRD-PARTY VIEWS

98. Third-party views have been discussed above where relevant.

UNDERTAKINGS IN LIEU

99. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

100. As explained in the OFT's guidance,[63] in order to accept undertakings in lieu of reference, the OFT must be confident that all the potential competition concerns that have been identified in its investigation would be resolved by means of the undertakings in lieu without the need for further investigation. The need for confidence reflects the fact that, once undertakings in lieu have been accepted, this is final in terms of the OFT's ability to refer, as section 74(1) of the Act precludes a reference after that point.

101. Undertakings in lieu of reference are therefore appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut. Furthermore, those remedies must be capable of ready implementation.[64]

102. The parties made offers covering a package of structural undertakings. [ ]

103. While the OFT welcomes the willingness of the parties to put forward remedies, it does not consider that the remedies proposed in this case are capable of operating in a clear cut way to remedy the competition concerns arising from the merger for a number of reasons.

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[63] Mergers - 'Exceptions to the duty to refer and undertakings in lieu of reference guidance' (OFT1122).
[64] Ibid, paragraph 5.8.

104. The remedies would not fully restore competition to the levels previously seen in the industry by replicating the existing constraint SO placed on VPS in either the social housing or commercial sector. This is because the remedies would not provide the necessary scale to provide the required competitive constraint on VPS. Some of the offers related to [ ], but the OFT also notes that its investigation has shown an element of reputation and track record with customers (both local authorities, commercial customers and intermediaries) and does not consider that this would necessarily be replicated by the offers. The OFT also notes that it is unclear how the [ ]. It is unclear to the OFT therefore that this aspect of the offered remedy is capable of ready implementation and moreover whether it would allow competitors effectively to compete against the new merged entity to win contracts.

105. Typically, structural undertakings require the sale of one of the overlapping businesses.[65] [ ]. Having examined the undertakings offered in this case, the OFT believes that they would not act in a clear cut manner to remedy or prevent the adverse competition effects identified and therefore the duty to refer remains.

ASSESSMENT

106. The parties overlap in the supply of vacant property security services consisting in particular of the sale, rental or installation of steel screens, doors and alarms in order to secure vacant property. They are the two leading specialist providers supplying social housing customers (local authorities, housing associations and registered social landlords) and commercial customers (retailers and pub chains). Such security services may be provided as part of a portfolio of vacant property services by the parties, as a standalone requirement, or on a subcontractor basis to intermediaries such as contractors or facilities management companies.

107. The appropriate frame of reference for the assessment of this transaction is the supply of vacant property security services to each of social housing and commercial customers separately. The OFT

[65] Ibid, paragraph 5.21

notes that there may be some constraints from a wider set of service offerings, such as wooden boarding and manned guarding, but, on the basis of the evidence available, the OFT does not consider these to be direct substitutes for the services supplied by the parties.

108. These services are provided by the parties from an extensive depot network across Great Britain and the evidence indicates that services may be capable of being provided up to 120 miles from a depot location. However, the parties have depots in a number of local or regional areas indicating that the geographic scope may be narrower than national. The appropriate frame of reference adopted is national but the OFT notes that regional or local issues may also arise.

109. The OFT found that the parties are each other's closest competitors in the supply of vacant property security services given that they have a high combined share of supply in each of the social housing and commercial customer segments and their win/loss data indicates that they win bids against each other on regular basis. The parties will increase their existing advantages in terms of geographic scale, amount of stock and equipment and size of workforce in comparison to their nearest rivals which are much smaller.

110. The OFT considered whether there would be any countervailing factors sufficient to outweigh a substantial lessening of competition in the supply of vacant property security services to social housing or commercial customers. The OFT found, on the basis of the evidence available to it, that entry and/or expansion was unlikely to be timely, likely or sufficient to replace the loss of rivalry occasioned by the merger. Most of the assets required for entry appear fairly readily accessible, however entry to replace the scale and scope of the parties may be difficult and there was no evidence of planned entry or expansion. In addition, over a number of years, the evidence points to several competitors, who with industry knowledge gained working at the main players, set-up their own operations, but without making sufficient evidence of headway into the sector.

111. There was limited evidence of buyer power from the commercial customers and the prospect of self-supply, to weaken competition between the merged entity, did not appear realistic other than for a few customers. Whilst, there exists a degree of buyer power for

some social housing customers consisting of the ability to run mini-tenders under framework agreements, the OFT considers that such constraint may in fact be reduced by a merger between the two leading national players

112. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in an SLC within a market or markets in the United Kingdom.

113. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.