

Anticipated acquisition by Babcock International Group plc of VT Group plc

ME/4488/10

The OFT's decision on reference under section 33(1) given on 25 June 2010. Full text of decision published 29 July 2010.

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. **Babcock International Group plc (Babcock)** is a public company incorporated in England and Wales, whose shares are listed on the London Stock Exchange. It provides asset management and support services to customers in the defence, nuclear, rail and power networks in the UK. Its activities include: training of military personnel, facilities management and infrastructure services, nuclear engineering, rail infrastructure services, power transmission network maintenance, telecommunications network maintenance and logistics support.
2. **VT Group plc (VT)** is a public company incorporated in England and Wales, whose shares are listed on the London Stock Exchange. VT is a UK-based support services company supplying engineering and other services and products. It is active in a wide range of market sectors including aviation, broadcasting, defence, emergency services, security, nuclear, waste, education and training.

TRANSACTION

3. The transaction involves the proposed purchase by Babcock of the entire issued share capital of VT. As a result of the transaction Babcock will acquire sole control of VT. The parties notified the transaction to the OFT

JURISDICTION

4. The OFT believes that the proposed transaction would result in two or more enterprises, Babcock and VT, ceasing to be distinct for the purposes of section 23(1) of the Enterprise Act 2002 (the Act). The UK turnover of VT exceeds £70 million (£745 million), so the turnover test in section 23(1)(b) of the Act is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION AND FILTERED CONCERNS

5. The parties overlap in a number of activities, distinguished broadly in this decision, for summary purposes only, as 'defence' and 'non-defence' sectors. In the non-defence sector, the parties' principal areas of overlap are in respect of the building schools for the future (BSF) programme, broadcasting infrastructure and civil nuclear decommissioning services. While within the defence markets, there are a range of potential and actual overlaps (see paragraph 26 below).
6. The OFT's investigation in this case has shown that certain of these overlaps can be filtered out as not raising any concerns. As a result, the decision takes the following structure:
 - non-defence markets are considered briefly below since in all cases these can be filtered out as no concerns arise
 - market definition for the defence markets is then considered
 - those defence markets which can be filtered out are then briefly considered
 - finally those defence markets where concerns were identified are analysed in more detail in the Horizontal Assessment section.

NON-DEFENCE MARKETS

Building Schools for the Future

Product Scope

7. Building Schools for the Future (BSF) is a programme, running between 2005 and 2020, to rebuild or renew all of England's 3,500 state secondary schools. The responsibility for overseeing this programme belongs to Partnerships for Schools (Pfs). Delivery is generally via either a national framework or via Local Education Partnerships (LEPs).
8. The parties are not major providers in this sector. Neither Babcock nor VT Group are listed on the existing framework agreement, which currently has 18 providers on it, and of 31 LEPs formed in the last four years, VT and Babcock have each won only one bid.ⁱ There are several major players active in this market Bouygues UK, Balfour Beatty, and Carillion who have each won more contracts than the parties.¹

Conclusion

9. No third parties raised any concerns about the effect of the merger on the BSF programme. The parties are relatively minor providers to the BSF programme via LEP partnerships, and are not currently a part of the constructor national framework. The parties and third parties identified a number of competitors such that any lessening of choice or competition arising from this merger is not significant. Therefore this sector is not considered further.

Communications and Broadcasting Services

Product Scope

10. The parties both offer services within the broad communications and broadcasting sector. The parties stated that, in the main, their activities were complementary and that the only overlap was with services related to the Digital Switchover (DSO) project. The DSO project is a Government backed programme to re-engineer the television distribution network, over

¹ Others considered to be competitors in this market include Interserve, Equitix, Vinci, Wates, Wilmott Dixon, Bovis, Laing O'Rourke, Skanska, Sir Robert McAlpine, Galliford Try and Costain

a seven year period, to switch from analogue and low power services to a new high power digital terrestrial network (due for completion in 2012). With respect to the DSO project, all contracts relating to the DSO project have already been awarded and therefore the merger has no impact.

11. Arqiva, the sole customer, stated that the parties may compete to supply subsequent maintenance services to small transmission relay stations within the network. However, they also considered there are several other viable suppliers of such services, for example [], [] and [], also capable of fulfilling any contracts that the parties might tender for, and it therefore had no concerns about the merger.
12. With the release of new radio spectrum and new technology, Arqiva anticipate that there may be new work streams related to further updates of the transmission network. However, again, Arqiva considered that the merger does not have a significant impact on the number of operators that could work on such projects.
13. The OFT also considered whether any potential competition existed between the parties, not reflected by current contracts. The OFT contacted a selection of customers relating to each activity the parties carries out in the communications and broadcasting sector. However, no customer concerns were received in response to these enquiries.

Conclusion

14. The parties' activities in communications and broadcasting do not raise any competition concerns and are therefore not considered further.

Nuclear services

15. The parties currently overlap with respect to nuclear decommissioning and may overlap with regard to:
 - services relating to current nuclear power generation
 - submarine decommissioning, and
 - nuclear new build projects.

16. With respect to nuclear decommissioning, the government is currently responsible for the decommissioning of nuclear power plants. The Department for Energy and Climate Change (DECC) sponsors the Nuclear Decommissioning Authority (NDA) which administers the allocated budget. In 2008/09 the NDA's allocated budget for 'decommissioning and clean up' was £1,369.9 million.² The parties do not overlap at the higher Tier 1 level of the market, and Babcock's share of supply at this tier is too low to raise concerns of foreclosure. At the lower levels of the supply chain the parties' activities do overlap and they are considered close competitors. However, in 2008/09 the merging parties had combined revenue in decommissioning of some [], equating to a combined share of some [] per cent of the overall nuclear decommissioning market.
17. The OFT last considered the UK market for nuclear decommissioning in 2008.³ At that time it was considered that the geographic market for the supply of decommissioning services was world wide and was characterised by a large number of rivals. The OFT has not received any evidence to suggest taking a different view in this case.
18. With respect to the other overlaps:
- Potential overlaps for services relating to current power generation and nuclear submarine decommissioning were also considered following a complaint from a potential competitor. The parties submitted that they did not currently overlap in support services for current power generation,⁴ and customers raised no concerns. With regard to nuclear submarine decommissioning, the Ministry of Defence (MOD) told the OFT that VT was not currently involved in submarine decommissioning and that the merger will not preclude competition in the future.
 - The parties stated that both aspire to provide services in connection with nuclear new build projects. Although there is little current

² As stated in the NDA Business Plan 2008/2009. In the 2009/2012 Business Plan, the NDA's allocated budget for 2009/10 for decommissioning and clean up has been increased to £1,772.7 million.

³ The OFT's decision on the completed acquisition by Babcock International Group plc of the Strachan & Henshaw Division of the Weir Group plc. 2 July 2008 www.of.gov.uk/OFTwork/mergers/decisions/2008/Babcock.

⁴ Babcock provides site management, outage, and maintenance support for current power generation, while VT offers consultancy, project and asset management services in relation to nuclear engineering.

activity, the government announced in November 2009 that the go ahead had been given for 10 new build nuclear power stations.⁵ The concerns of competitors in this area were not supported by comments from customers and relevant government departments, who expect there to be significant competition in the new build sector going forward.

Conclusion

19. On the basis of the evidence before it the OFT does not consider that the merger gives rise to a realistic prospect of a substantial lessening of competition in nuclear services, and therefore this sector is not considered further.

DEFENCE RELATED ACTIVITIES

20. The parties overlap in the provision of support services in the defence sector, which, they suggest, can, be grouped into the following activities:
- provision of training and related services, sub-divided by military sub-segment — air, land and sea
 - provision of equipment support services, sub-divided by military sub-segment — air, land and sea. Equipment support covers a very wide range of services and equipment, generally supplied as an adjunct to other services. It includes after-sales maintenance and support services, and
 - provision of infrastructure/facilities management (FM) services – FM services may be further split into hard FM and soft FM. Hard FM generally includes building and ground services, estate management etc., while soft FM includes catering, clearing, security services etc. In the defence sector, there is also a range of technical support services, which are delivered to the MOD, together with soft FM services, through multi-activity contracts (MACs). These technical services include logistical, airfield and administrative support services. The scope and the range of services included in MACs depend on the

⁵ http://news.bbc.co.uk/1/hi/uk_politics/8349715.stm

MOD's specific requirements for a particular station and will vary in each contract.

21. There are a number of features common to all defence related activities, including:

- that the MOD is the sole customer for all UK defence contracts
- defence contracts are awarded through a competitive tender process, in accordance with public sector procurement rules. Increasingly, the award of defence contracts follows a competitive dialogue procurement process⁶ and
- due to the size of the contracts and the different capabilities involved, services are typically provided to the MOD at different levels of the 'supply chain', Tier 1, Tier 2, Tier 3 etc. Generally, the MOD contracts with the Tier 1 provider (also referred to as prime contractor) who will then sub-contract services to other providers (referred to as sub-contractors):
 - The prime contractor acts as a 'services integrator' and is responsible for delivery and performance of the overall contract. It is common for market participants to form consortia or joint ventures to tender for large Tier 1 contracts. Prime contractors typically also provide part of the services to be performed or delivered pursuant to the contract.
 - Sub-contracts may be awarded through a competitive process or bilateral negotiation. While the MOD deals with the prime contractor only, some sub-contractors, which represent a strategic partner are tied into the bid and included in the team for the Tier 1 contract.⁷

⁶ Through a competitive dialogue procurement process, following a pre-qualification procedure, the authority discusses, typically in successive stages, the form of the contract and the technical specifications of the project with selected bidders before the key tender documents are issued.

⁷ The parties indicated that the MOD oversees and may intervene in the selection of sub-contracted providers and the terms on which they contract. For example, the MOD may insist that sub-contractors are selected competitively.

Product Segmentation

22. While Babcock indicated that the provision of support services to the defence sector did not fit naturally within narrow categories for the purposes of market definition, it suggested that it may be appropriate to:
- distinguish between civil and military training, due to the different material and software applications employed.⁸ Within defence, the two major areas for training will be skills training and combat training. Babcock submitted that only skills training is outsourced
 - distinguish between air, land and sea training⁹
 - distinguish between air, land and sea requirements for equipment support services, and
 - take into account that, in relation to FM services, since these cover a broad range of activities, the precise scope of the services provided on any given contract would be driven by the specific customer demand.
23. MOD indicated that it broadly agrees with the categorisation of the defence business proposed by the parties,¹⁰ but it also stated that the MOD's contracts regularly span more than one activity (training services, equipment support services and facilities management).
24. For market definition purposes the OFT has focused on demand-side substitutability considerations. The different support services – that is training, equipment support and FM – are not considered to be a substitute for each other. The same may hold true if these services are split in terms of air, land and sea. While hard FM and soft FM can be regarded as sub-segments of the overall FM sector.
25. The OFT also considers that the existence of MACs in the defence sector, which include the provision of technical services together with soft FM services, makes it appropriate to split the provision of soft FM services into

⁸ European Commission, Case no IV/M.1438, British Aerospace/GEC Marconi (1999).

⁹ European Commission, Case no COMP/M.3720, BAES/AMS (2005).

¹⁰ Competitors to the parties in the provision of support services in the defence sector also broadly confirmed Babcock's view on market definition.

two sub-segments, referred to as 'traditional soft FM services' and 'FM services through MACs'.¹¹ Traditional soft FM will not be considered further as neither party is active in this segment. Their only involvement in soft FM is as services integrators and providers of technical services in MACs.

26. For the purpose of considering the effect of the merger in the defence sector, the OFT has identified the following frames of reference:

- air training and related services
- land training and related services
- sea training and related services
- air equipment support services
- land equipment support services
- sea equipment support services
- hard FM services, and
- FM services through multi-activity contracts (MACs).

However, the OFT recognises that the boundaries of these markets may be blurred to some extent since MOD, as the sole customer in these markets, may alter the way in which it demands services so that contract awards may cover a range of services, possibly across the different Armed Forces. In other words, it has been necessary to take into account in the OFT's assessment the fact that ultimately each contract will be tailored to meet MOD's specific requirements. In addition, contracts for the provision of these services are typically infrequent and long-term and there is competition to win these contracts through tender processes. Generally, therefore the OFT has concentrated in this case on the effect of the merger on competition for future requirements.

27. Each of these markets is considered briefly below, except for the markets for land training (contracts above £10m) FM services through MACs, and sea training, including the Future Outsourced Activities Programme contract, which have been considered in more detail in the next section (Horizontal Issues).

¹¹ See paragraph 20

Geographic scope

28. The parties have argued that, for all defence support services, the geographic scope of the market is worldwide since the MOD generally conducts international tenders and there are a significant number of non-UK competitors able to serve the market.
29. The OFT has noted the parties' arguments; however, it considers that there may be a national preference for some contracts due to the MOD's specific bid requirements. Where this is the case, a consortium or partnership with a national player may make it easier for an international player to win the contract.
30. However, in this case, the OFT has not been required to conclude on the geographic scope, since it would not affect its conclusions.

Defence sector activities, which were not considered to require in depth analysis

31. The parties are involved in a number of defence related sectors. The OFT has been able to filter some of the sectors where no competition issues were raised, these are considered below.

Air training services

32. Babcock and VT have competed against each other for some contracts in the past. However, there is currently minimal direct overlap between the parties in their respective activities in this area. VT currently provides flying instruction services (predominantly as a Tier 1 or 2) while Babcock provides equipment and technical support services to training platforms (predominantly as a Tier 3). The parties submitted that there were a number of other providers available, such as Serco, Marshall Aerospace and Cobham Aviation Services, together with original equipment manufacturers (OEMs), such as BAE Systems, Pilatus and Alenia Aermacchi. This view was supported by third parties.
33. On the basis of the evidence before it the OFT does not consider that the merger would give rise to a realistic prospect of a substantial lessening of competition in the provision of air training services, and therefore this sector is not considered further.

Land training services – small contracts (with value below £10 million)

34. The parties and third parties identified a number of alternative providers able to compete for smaller contracts. Besides Serco and the Metrix consortium, these include companies such as Pennant Training Systems, PDM Training and Consultancy, and TQ Training Management Services. On this basis the OFT considers that the provision of land training services for small contracts (with a value below £10 million) does not give rise to the realistic prospect of a substantial lessening of competition and will not be considered further.

Air equipment support services

35. The parties overlap in the provision of air equipment support; however, neither company occupies a major position in this area. There are a number of alternative providers available, including OEMs, such as BAE Systems, who are the major providers of equipment support to the MOD; other service providers such as Serco, Marshall Aerospace and Vector Aerospace; and the Defence Support Group (DSG), an MOD trading fund organisation.
36. For the reasons outlined above, no competition concerns are considered to arise in air equipment support and this market is not considered further.

Land equipment support services

37. The parties stated that their activities in land support services were focussed on different elements of the land equipment market, with Babcock providing support services to specialist military vehicles and VT mainly providing support services to non-military vehicles.
38. Neither company holds a significant position in this area, and there are alternative providers available. In particular, OEMs are major suppliers to the MOD and the DSG also provides support services for a range of land platforms.
39. The OFT therefore considers that no competition concerns arise in the provision of land equipment support services and this area is not considered further.

Sea equipment support services

40. The provision of sea equipment support services is not considered further since VT, following its exit from the BVT joint venture in 2009, is no longer active in this sector [].¹²

Hard FM services

41. Although Babcock is a major provider of hard FM services to the MOD,¹³ VT's activities in this area to date have been limited. The parties and third parties identified many alternative providers of hard FM services, including companies such as Carillion, Balfour Beatty, Mitie, Kellogg, KBR and Capita.

42. The OFT therefore considers that the merger would not give rise to a realistic prospect of a substantial lessening of competition in the provision of hard FM services and therefore this sector will not be considered further.

HORIZONTAL ISSUES

43. In this section the OFT considers the horizontal overlaps between the parties where it has not, up till now, been able to screen out competition concerns.

Relevant counterfactual

44. Competition assessment in merger cases compares the situation arising through a merger transaction with that which would have existed in the absence of the transaction ('the counterfactual'). The pre-merger scenario is usually the preferred counterfactual for the OFT, unless there is good reason to depart from it. Babcock has made no submissions that an alternative counterfactual is appropriate in this case and the OFT has not received any evidence to indicate that it should depart from the pre-merger scenario as the appropriate counterfactual.

¹² BAE and VT formed the BVT Joint Venture in July 2008 to provide surface warships and through-life support to the MOD (and other customers globally). On July 2009 VT notified BAE that it intended to exit the JV. The share purchase agreement was signed on September 2009.

¹³ Babcock holds two Regional Prime Contracts (RPC), the South West RPC and the East RPC.

FM services through MACs – for contracts with a technical component

45. The parties overlap in the provision of FM services through MACs at MOD establishments. Babcock and VT act as the prime contractor (Tier 1) providing the technical support services, while subcontracting the soft FM activities to companies such as ESS, Aramark and Sodexo.
46. The parties submitted that the split between technical support services and soft FM services within MACs will vary between contracts depending on the MOD's specific requirements, which will differ from contract to contract. MAC contracts may cover elements of:
- mission delivery and support of mission systems, for example tanks and aircraft
 - technical support of non-mission equipment needed to sustain operations, for example maintaining vehicles and airfield systems
 - hard FM, for example buildings maintenance, and
 - soft FM, for example catering and cleaning.

Because there is no straight split between the elements of soft FM and the more technical elements in a MAC, the parties interpreted 'more technical MACs' as those involving a significant provision of services other than soft FM. [].¹⁴

47. The parties currently hold the following MACs: Babcock at RAF Valley¹⁵ and RAF Linton on Ouse;¹⁶ and VT at a number of RAF bases, including RAF Brampton, RAF Wyton and RAF Henlow¹⁷ and DCAE Cosford.¹⁸

¹⁴ See footnote 20 below.

¹⁵ Awarded in 2004, five + three year contract, Total Contract Value (TCV) £65 million. The parties indicated that this contract is primarily centred on the provision of more technical services, which overall account for approximately 84 per cent of the TCV.

¹⁶ Awarded in October 2009, five + three year contract, Total Contract Value (TCV) £10 million (for five years). The parties indicated that this contract is primarily centred on the provision of more technical services, which overall account for approximately 77 per cent of the TCV.

¹⁷ Awarded in April 2009, five year contract, TCV £7.9 million. The parties indicated that this contract is primarily centred on the provision of soft FM services, but that more technical services are operationally significant, the latter account for approximately 20 per cent of the TCV.

¹⁸ Awarded in September 2008, three + three year contract, TCV £4.4 million. The parties indicated that this contract is primarily centred on the provision of soft FM services, but that more technical services are operationally significant, the latter account for approximately 30 per cent of the TCV.

48. The parties advised that in the last five years several MACs had been put out to tender (two contracts are yet to be awarded).¹⁹ Four out of 13 contracts were classified by the parties as 'primarily soft MACs'. In three out of these four contracts, soft FM services accounted for 100 per cent of the Total Contract Value (TCV).
49. Babcock and VT competed against each other in [] of the 13 tenders, including those for the four contracts currently held by VT. In [] of the [] instances, the tender has been classified by the parties as 'primarily a soft FM MAC'.²⁰ In one of the [] instances, the contract is yet to be awarded.
50. The parties identified a number of other bidders, in competition for these contracts as 'providers of technical support services'; these include Serco, Carillion, Interserve and Turner Facilities Management.
51. In those MAC tenders where Babcock and VT competed, Serco also bid. Besides Serco, there were at most two other providers²¹ of 'technical support services' and they competed in, at most, two tenders over the last five years.

The parties' view

52. The parties submitted that no adverse impact in the provision of FM services through MACs may be expected following the merger, given the large number of competitors active in this area. The parties indicated that their closest competitors for MACs with a larger technical support component were often determined by the type of service required for the particular station and may include Serco, Turner Group, MITIE, Interserve and Carillion as well as other, more specialist players. In relation to the provision of FM services in general, the parties also noted that, given the wide range of services included in the contracts, consortia were common.

¹⁹ The parties classified these MACs as either within the 'air equipment support services' or within the 'infrastructure/FM services'.

²⁰ Babcock indicated that in one tender []; and []. In the third case, Babcock indicated that soft FM services accounted for 80 per cent of the TCV and more technical services account for the remaining 20 per cent.

²¹ Cobham Aviation Services UK, Turner Facilities Management, Carillion Defence, Interserve, Elixor, and G4S

Third parties' views

53. As sole customer, the MOD submitted that the impact of the merger in the provision of FM services through MACs would be minimal. Their submission largely confirmed the parties' views that MAC contracts tended to combine elements of 'soft' FM services with technical support service elements and typically Babcock, VT and their competitors would act as prime contractor providing the engineering services, while sub-contracting the soft FM services to companies such as ESS, Aramark and Sodexo. The MOD indicated that a wide range of companies with capabilities to subcontract the elements that may otherwise have been covered by Babcock or VT were showing a significant interest in this area, and it expected this to continue post merger. The MOD said that SERCO, Interserve and Carillion have all recently competed against VT and Babcock to be the prime contractor for MACs at RAF bases [].
54. Two third parties commented that the merger would create a very strong competitor for MACs which include the provision of technical support services, one expressing a concern about what it described as 'the dominant position' of the merged entity in this area.

Assessment

55. The tender history shows that the parties are close competitors for MACs which entail some provision of technical support services. They competed against each other [] in the last five years, both as Tier 1 and as providers of the technical services. For MAC tenders classified by the parties within the 'infrastructure/FM services' segment, competitors identified by the parties as a 'provider of technical support services' appear to be Serco, Elixor, Interserve FM, Carillion, Turner FM, Emcore Facilities Management, RR Richardson and G4S Integrated Services. Broadly, these same competitors compete for tenders for MACs within the 'air equipment support services' segment, and where contracts have an aircraft engineering support element other companies, such as Marshall Aerospace and Cobham Aviation Services, may also bid.
56. The OFT recognises that the lines that classify a MAC tender as comprising a larger technical or soft FM component are blurred to some extent. However, ultimately the pool of competitors will largely depend on MOD requirements for any specific MAC. In this respect, the tender history

shows that many companies are active in this area and bid in the past few years for Tier 1 MAC contracts.

Conclusion

57. Based on the evidence available and the arguments set out above, the OFT considers that there is no realistic prospect that the merger would give rise to a substantial lessening of competition in the provision of FM services in relation to future MOD requirements for MACs which include a technical support services component.

Land training services – large contracts (with total value over £10 million)

58. As well as the smaller value contracts for land training discussed at paragraph 32 above, the parties undertake similar activities and competed against each other for large land training contracts.

59. Babcock currently holds the Royal School of Military Engineering (RSME) contract (in consortium);²² and VT the Training, Maintenance and Support Services (TMASS) contract at Bovington.²³ In the last five years, there have been six contracts for land training services with a total value over £10 million. One of these contracts, the Combined Arms Tactical Trainer Training Services (CATTTTS), was not put out to tender, while another, the Defence Training Rationalisation Programme (DTR), has been split into two packages, Package 1 and Package 2, each put out to tender separately. Therefore, there have been six tender processes overall.²⁴

60. VT competed in [] tenders, while Babcock competed in [] tenders. The parties competed against each other (either alone or in consortium with others) in [] instances, namely the tenders for [], and in both cases the only other competitor was Serco.

61. However, this was not the case for the DTR Package 1 tender, which relates to engineering, communications and information systems training. Only two selected bidders continued to the final stages for this contract —

²² Awarded in December 2008 to the Holdfast consortium (Babcock with Carillion, MidKent College, TQ and ESS); 30 years contract; TCV £3 billion.

²³ Awarded in April 2008; five +three year contract; TCV £32.6 million.

²⁴ These are tenders for the following contracts: TMASS, RSME, Recruiting Partnering Project, REME, DTR Package 1 and DTR Package 2.

Metrix and MC3 Solutions (a consortium including VT, BAE Systems and Carillion). The preferred supplier is the Metrix consortium (led by Qinetiq and Sodexo, with Raytheon and others).

62. The contract for DTR package 1 is 25 years with a TCV of approximately £10 billion. DTR Package 2 is yet to be awarded. However, it is intended that this will cover training for logistics, personnel administration, police, guarding, and security etc. Here the Metrix consortium is bidding against the Holdfast consortium led by Babcock.²⁵
63. Similarly for the Recruiting Partnering Project, a 10-year contract with a TCV of £1.4 billion, which has not yet been awarded (the award is expected in November 2011), after the pre-qualifying questionnaire (PQQ) stage, four firms / consortia have been selected to bid: Mulberry, a consortium led by VT; Prospector, a consortium led by Serco; G4S Recruiting Alliance, a consortium led by G4S; and Capita.

The parties' view

64. The parties submitted that there are a number of competitors providing land training services. Of the [] contracts with a value above £10 million tendered in the last five years,²⁶ Babcock, VT and Serco were the only sole (that is not in a consortium) competing providers in only [], while in all the others there were many competitors. The parties considered that smaller players, through consortia,²⁷ were credible competitors for contracts, and that OEMs²⁸ would also provide land training services in connection with the equipment and vehicles they supply. The parties also stressed that the MOD was free to provide the relevant training in-house; and that the MOD has significant countervailing buyer power.

²⁵ Babcock indicated that the Metrix consortium was appointed as a provisional preferred bidder for the DTR Package 2 in January 2007. Babcock's internal documents suggest that the combined entity Babcock/VT, by joining Babcock FM capabilities and VT training analysis, 'will provide a complete solution for DTR2'.

²⁶ The parties include the CATTTS contract, but not the DTR Package 2.

²⁷ Eg, Metrix.

²⁸ Eg, Land Rover, MAN, Volvo, Osh Kosh, Rolls Royce and BAE. The parties cite the CATTTS contract as an example of the OEMs involvement. The CATTTS is the sub-contract to the CATT contract relating to training services. The prime contract was awarded to Lockheed Martin (directly, without any tender process), while the sub-contract was signed by Lockheed Martin and BAE Systems.

MOD's view

65. The MOD indicated that, for future requirements in excess of £10 million (which fall outside the scope of the DTR), it will largely be reliant on Serco, and any new entrant (consortia or other support providers), to provide effective competition to the parties.
66. However, the MOD also commented that whilst it was true that, the historic competition for contracts greater than £10million had primarily been between Babcock, VT and Serco, it considered that there was not much difference between outsourced training for air, land or sea and there were indications that providers in the other areas, that is air or naval trainers, could expand or enter this area. The selection of the Metrix consortium as the preferred supplier for the DTR Package 1 was an example of relatively small playersⁱⁱ teaming up together and becoming credible competitors for large contracts. These companies may compete for future MOD's requirements. Further, [] and [] were bidding for the Recruiting Partnering Project against [] and []; and KBR and Qinetiq were also considered as potential competitors.
67. The MOD also noted that while, historically, OEMs were not viable players in this area, as they were for example in air training, they may turn more widely to support services in the future if new equipment opportunities were reduced []. However, these companies are seen as specialist vehicle providers and any land training they may provide would more likely be limited to that related to driving and maintaining the specialist vehicles supplied to the MOD.²⁹

Assessment

68. The tender history has shown that the parties competed against each other in only [] tenders in the last five years. While Babcock, VT and Serco have been the only competitors bidding (either alone or in consortium) for some large land training contracts and are considered important players for all these tenders, other players, that have not historically bid, have been successful in winning very large contracts and are currently bidding in

²⁹ The MOD also indicated that currently driver training is typically provided to the Armed Forces by driver training businesses rather than OEMs.

contract tenders. The Metrix consortium³⁰ is a relevant example of relatively small playersⁱⁱⁱ teaming up together and together becoming credible competitors for large contracts. Although, historically, OEMs do not appear to be significant players in the provision of land training, the OFT notes MOD's view that they might turn more widely to support services in the future should new equipment opportunities be reduced.

Conclusion

69. Based on the evidence available and the arguments set out above, the OFT believes that there is no realistic prospect that the merger would give rise to a substantial lessening of competition in the provision of land training services in relation to future MOD requirements for large land training contracts (with a value over £10 million).

Sea training and related services – Future requirements other than those covered by the FOAP contract

70. There are no current overlaps in the provision of sea training services.
71. The sea training contract for the Future Outsourced Activities Programme (FOAP)³¹ is due to run for 15 years and is considered by both the parties and the MOD to comprise the bulk of naval training going forward. (See below for assessment of the current tender for the FOAP contract). However, it was also considered that there may be some smaller contracts for training in the naval sector in the short term.
72. Both the parties and the MOD, as sole customer, agreed that there were few differences between the outsourced contracts for air, land and sea training. All involved skills training rather than combat training and covered such training as engineering, maintenance, electronics etc. These were all areas capable of being covered by civilian trainers.³²

³⁰ The Metrix Consortium is led by QinetiQ and Sodexo, with Raytheon, Laing O'Rourke, City and Guilds, The Open University, Nord Anglia, and HP.

³¹ See paragraphs 75 to 102 below

³² For example the preferred bidder for DTR Package 1 is Metrix which is led by QinetiQ and Sodexo and includes Raytheon, City and Guilds, the Open University and Nord Anglia Education.

Assessment

73. The evidence received by the OFT indicates that the FOAP training contract considered below encompasses most of the MOD's sea training requirement going forward and that there are no planned major tenders for naval training after FOAP. Therefore, it is expected that any contracts put out to tender in the near future will be small. As in other areas of the defence sector, the market for smaller contracts appears to be more contestable and a number of providers available. Besides BAE Systems and QinetiQ, these may include for example some of the 28 companies who expressed an interest for the FOAP training contract.³³ In the longer term, it is likely that the only large scale contracts will come after the FOAP contract (an initial six years extendable to 15) expires.

Conclusion

74. Based on the evidence available and the arguments set out above, the OFT does not consider that the merger would give rise to a realistic prospect of a substantial lessening of competition in the provision of sea training services in relation to MOD's future requirements.

Sea Training Services – Current tender for the FOAP training contract

75. As noted above, the parties do not currently overlap in the provision of sea training services to the MOD. Although VT, through VT Flagship, is the incumbent supplier, its contract to provide training services to the Royal Navy expires in 2011. However, the MOD is currently in the final stages of the tender process for the training element of the Future Outsourced Activities Programme (FOAP). Babcock [] Raytheon [] VT [] and Serco are currently participating in this competition.

76. The training element of FOAP is likely to be worth up to [].³⁴ The MOD has advised that this contract represents the bulk of naval training in the UK. Since the contract will last for a significant period of time, the OFT considers that any competition is **for** the market rather than **in** the market. Once the tender process is complete and a winner announced the OFT

³³ Babcock indicated that these companies included 'integrators' as well as 'specialist providers'.

³⁴ Babcock submitted that the annual value of the contract is approximately [] and the TCV is approximately [].

understands that there will be limited further competition for this sector until the contract is re-tendered (see paragraph 71 above).

77. By way of background, the contract for the provision of sea training services under FOAP was originally put out to tender in January 2009. The MOD received initial expressions of interest from 28 companies. Pre-qualification, in June 2009, saw four companies selected by MOD to go forward to the competitive dialogue process. These were VT, Babcock, Raytheon and Serco, two other companies qualified at pre qualification (PQQ) but were not carried forward to the next stage. In August 2009, Babcock and Raytheon decided to team together to form a joint bid, [].³⁵ This arrangement was agreed with the MOD. Babcock and Raytheon entered into a formal Teaming Agreement which set out the roles that each would play in the bidding process, how (if successful) the work areas would be allocated, and the provisions that would apply if either party withdrew from the teaming arrangement. The three remaining bid teams submitted revised outline solutions to MOD by the end of May 2010.
78. Going forward, the MOD will undertake a third round of consultation to be completed by the end of July, tender documents will be issued by MOD in September 2010, and by October 2010 the bidding teams will be required to propose a refined solution. After this the MOD will issue a revised statement of requirements, inviting the teams to respond to these.^{iv} It is currently envisaged that the preferred bidder will be selected on or around May/June 2011. The contract is due to be signed in October 2011 with the service commencing on 1 January 2012.

MOD's view

79. The MOD initially expressed concern over the merger's impact on the integrity of the FOAP contract competition, since the parties were represented in two of the three teams bidding for the contract. The MOD was concerned that the merger may provide an incentive for the parties to withdraw the least advantageous bid, possibly leaving only two teams in the competition for the contract. MOD did not consider it feasible, at this stage of the process, to either invite a replacement company to participate or to restart the tender process because the current Flagship training contract (held by VT) was due to expire in 2011.

³⁵ []

80. To address the MOD concern, Babcock provided the MOD with a Deed of Undertaking effective from 27 May 2010 (the Deed) under which Babcock committed that, insofar as its role in each team permitted, the teams would both remain competitors in the FOAP tender process. [].³⁶

81. The MOD believed that the assurances contained within the Deed, addressed the initial concerns which it had regarding the potential for the merger to adversely affect the FOAP bidding process.

Babcock's view

82. Babcock considered that the merger would not give rise to any realistic prospect of a substantial lessening of competition in any meaningful market in relation to the FOAP training contract tender process.

83. Its main arguments are explored below.

Babcock's incentive to compete with Serco

84. Babcock submitted that its overriding incentive will be to win the bid, either as owner of VT post merger, or in partnership with Raytheon. [].

85. [].

86. [].

Lack of ability to worsen either the Raytheon bid or the VT bid post merger

87. Babcock submitted that even if it wished to worsen either of the bids, in practice it would not be able to do so. This is because it is subject to legally binding obligations, to both Raytheon under the Teaming Agreement (see paragraph 77 above) and to the MOD under the Deed (see paragraph 81 above) the net effect of which is to require it to pursue each bid separately, in good faith, and to the utmost of its ability.

88. [].³⁷

³⁶ [].

³⁷ [].

89. As explained above, Babcock indicated that, under the Teaming Agreement, [].

90. [].

MOD's countervailing buyer power

91. Finally, Babcock argued that the merger would not affect the ongoing competition for the FOAP contract since, until the merger completes, the bidding teams of the respective parties (notwithstanding Babcock's comment above that the Raytheon/ Babcock team is led by Raytheon) would remain separate. The period post-merger would be covered by the Deed (see paragraphs 81 and 82).

92. Babcock considers that the MOD's insistence on them entering into the legally binding obligations to hold the bid teams separate in the Deed is indicative of the countervailing buyer power that it enjoys.

93. Since the defence sector accounts for the large majority of the parties' total income, Babcock points out that it is dependent on retaining the MOD's goodwill. Any attempt to worsen either bid would damage Babcock's reputation as a credible and reliable bidder for future MOD contracts. [].

Assessment

94. The parties do not currently overlap in the provision of sea training services. The sea training element of FOAP is currently going through the final stages of the tender competition and the parties are present in two of the three bidding teams.

95. The tender process is at an advanced stage: the bidding teams and MOD completed the second stage of dialogue around each bidder's outline offer by the end of May. As outlined at paragraph 77 above the MOD plans to issue formal tender documents in September and the bidding teams are due to submit their final offers in October 2010. Negotiations with the MOD around the final solution and price offer are then expected to take place until the selection of a preferred bidder in May 2011.

96. The OFT has considered whether, following the merger, there could be a substantial lessening of competition in the bidding for the FOAP sea training contract. This could occur as a result of the merged entity bidding less aggressively for either or both of its bids (ie VT alone and Raytheon/Babcock) – or in an extreme situation withdrawing from one of the two bids. The OFT has considered whether the merged entity would have the ability and incentive to worsen, first, the VT bid and, second, the Raytheon/Babcock bid.

97. The OFT does not believe that the merged entity would have the ability and incentive to worsen (or withdraw) the VT bid.

- In terms of ability, the merged entity might presumptively be considered to have the ability to worsen the VT bid given that it is in sole control of it. However, the OFT notes that this could put Babcock in breach of its obligations to the MOD under the Deed and would severely risk damaging the merged entity's reputation with the MOD going forward.
- In any event, the OFT does not believe the merged entity would have any incentive to worsen the VT bid. Given that the merged entity would gain 100 per cent of the value of the bid as Prime, it wishes to maximise its prospects of winning this bid as against the Serco bid and as against the Raytheon bid (with or without Babcock). To the extent that the merged entity wished to maximise its prospects of winning either of its bids, it would not be willing to damage the VT one. Put differently, the Raytheon/Babcock team would only have a 50 per cent chance of winning the bid if VT's bid were to be unsuccessful, and the fact that Babcock, [], is (at most) [] per cent of the Raytheon bid team, which reduces the effective diversion ratio from VT to the Babcock part of the Raytheon/Babcock team to some [] per cent (that is [] per cent of 50 per cent).

98. Nor does the OFT believe that the merged entity would have the ability to worsen the Raytheon/Babcock bid (even if it might be considered to have the incentive to do so).

- First [].

- Second, the merged entity risks being in breach of the Deed it has entered into with the MOD. [].
- Third, even if Babcock were (in an extreme situation) to withdraw from the Raytheon bid, since the MOD selected Raytheon after the PQQ stage as a qualified bidder for the Tier 1 contract, it may be reasonable to consider that Raytheon would be able to remain in competition without Babcock in the team. Certainly, the OFT has no evidence (including any evidence from Raytheon) that this is not the case.
- Fourth, there is evidence to suggest that Raytheon would be able to limit the extent to which Babcock could in practice worsen the Raytheon bid. [].

99. The OFT has considered the possibility of Babcock worsening both bids, but notes that the reservations about whether it would be able to worsen the Raytheon bid apply to this situation. Furthermore, the OFT is cognisant of Serco's presence in the tender process, which would mean that worsening both bids may strengthen the bid of the third competitor.

100. The OFT has also considered whether the MOD can be said to have buyer power. The UK defence industry is unusual in that the purchaser is a monopsonist, and there is little prospect of other potential customers that could suffer an adverse effect as a result of the merger. In particular in this case MOD's ability to obtain the Deed; the fact that it has, albeit not as a result of the merger, changed the tender process and there remains scope for it to be changed again should it choose; and the fact the MOD has retained three competing bidders in the process, when it could have down selected to two, and can choose to retain three bidders to the end of the process, all contribute to evidence of buyer power in respect of this current FOAP tender

101. Therefore, taking all the evidence into account, the OFT does not believe that there is a realistic prospect that the merger would give rise to a substantial lessening of competition for the current tender round for sea training under FOAP.

THIRD PARTY COMMENTS

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

ASSESSMENT

103. The parties overlap in a number of activities, which can broadly be distinguished as either defence or non-defence sectors. The OFT's investigation concluded that the non-defence markets, building schools for the future, communications and broadcasting and nuclear services, did not raise competition concerns.
104. Equally, in the defence sector the OFT concluded that there were markets which did not raise competition concerns. These include air training services, small contract value land training services, air equipment support services, land equipment support services, sea equipment support services and hard FM services.
105. There were four areas where the OFT was unable to screen out competition concerns on a preliminary basis and which are considered in more detail in the decision above. These are FM services through multi-activity contracts, land training services for contracts valued over £10 million, sea training and related services (other than those covered by the Future Outsourced Activities Programme (FOAP)) and sea training services under the current tender for the FOAP training contract.
106. MAC contracts cover many elements, including support of mission systems, maintenance of vehicles and airfield systems, hard FM, and soft FM. Because there is no definitive split between the soft FM and the more technical elements in a MAC, the parties submitted that 'more technical MACs' were those involving a significant provision of services other than soft FM. The OFT's investigation confirmed that the lines that classify whether a MAC can be considered to be either technical support or soft FM are blurred to some extent and that ultimately the pool of competitors will depend on MOD requirements for specific MACs. Tender history has shown that there are many companies active in this area and that have bid for Tier 1 contracts in competition with the parties. Therefore, based on the evidence available the OFT considers that there is no realistic prospect that the merger would give rise to a substantial lessening of competition in

the provision of FM services in relation to future MOD requirements for MACs which include a technical support services component.

107. In land training services for contracts valued over £10 million, the OFT notes that tender history shows that the parties competed against each other in only [] tenders in the last five years. In addition to other competitors, it is also notable that smaller competitors can form consortium bids and thus impose a constraint. This is shown by the recent award of preferred bidder status to the Metrix consortium for the DTR1 package. In light of the relatively limited head-to-head competition and in the presence of other competitive constraints, the OFT believes that there is no realistic prospect that the merger would give rise to a substantial lessening of competition in the provision of land training services in relation to future MOD requirements for large land training contracts (with a value over £10 million).
108. In relation to the MOD's future requirements for sea training services, the OFT concluded that since the FOAP sea training contract is due to run for 15 years and is considered by both the parties and the MOD to comprise the bulk of naval training going forward, it is likely that any other contracts will be small. In addition, the OFT considered that, in the sea training services sector, the market for smaller contracts appears to be contestable. In particular, there are a number of alternative providers to the parties. Such alternative firms include the six providers that were successful at the pre qualification questionnaire stage of the current FOAP tender, and also some of the 28 companies that initially expressed an interest in bidding for the FOAP contract. The OFT therefore considers that the merger would not give rise to a realistic prospect of a substantial lessening of competition in the provision of sea training services in relation to the MOD's future requirements.
109. The OFT has also considered whether, following the merger, there could be a substantial lessening of competition in the current bidding for the FOAP sea training contract. This could occur as a result of the merged entity bidding less aggressively for either or both of its bids (that is VT alone and Raytheon/Babcock) or withdrawing entirely from one of the two bids. However, the OFT believes on the basis of its investigation that the merged entity would not have the ability and incentive to worsen (or withdraw from) either the VT bid or the Raytheon/Babcock bid.

110. For the reasons given above at paragraphs 95 to 101, the OFT does not believe that there is a realistic prospect that the merger would give rise to a substantial lessening of competition for the current tender for sea training under FOAP.

111. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

112. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

ⁱ The parties clarified that VT had won two BSF bids.

ⁱⁱ MOD clarified that the selection of the Metrix consortium as the preferred supplier for the DTR package 1 was an example of companies, which would perhaps not have been considered traditional training providers, putting together teams with the range of skills to become credible competitors for large contracts.

ⁱⁱⁱ See end note ii above.

^{iv} MOD clarified that if it did not get affordable, compliant tenders, it has the right to reopen dialogue with the bidders.