Anticipated acquisition by Elster Group GMBH of the water meter and boundary box business of Severn Trent Metering Services

CR/20/09

The OFT's decision on reference under section 33(1) given on 29 April 2009.
Full text of decision published 28 May 2009

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. **Elster Group Gmbh** (Elster) is a CVC Capital Partners portfolio company and is primarily focused on the manufacture and supply of integrated metering and utilisation solutions for the gas, electricity and water industries. In the UK, Elster is active in the design, manufacture and sale of water meters, electricity meters, gas meters and gas utilisation. The Group's UK turnover in 2008 was [ ] million, [ ] million of which was derived from water metering.

2. **Severn Trent Metering Services (STMS)** is a subsidiary of Severn Trent plc. STMS specialises in water technology and its core business is the design, manufacture and supply of residential water meters and boundary boxes to water utility customers. Elster is proposing to acquire the water meter and boundary box assets of Severn Trent Metering Services (**Target Assets**). The UK turnover of the Target Assets in the financial year ended 31 March 2008 was [ ] million.

TRANSACTION

3. On 4 March 2009 Elster announced its proposed acquisition of the Target Assets by an Asset Purchase Agreement concluded between Elster Meter Limited (EML), a wholly-owned subsidiary of Elster Holdings UK Limited

(and ultimately Elster) and Severn Trent Services, a member of Severn Trent plc on 27 February 2009. The OFT received a satisfactory submission by the parties on 2 March 2009 and the administrative deadline is 29 April 2009.

JURISDICTION

4. As a result of this transaction Elster and the Target Assets will cease to be distinct within the meaning of section 26(1) of the Enterprise Act 2002 (the Act). The share of supply test in section 23 of the Act is met as the parties' combined share in the supply of residential water meters in the UK exceeds 25 per cent. 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

Product scope

Introduction

5. Residential water meters are those fitted to pipes between 15mm and 40mm in diameter. Commercial and industrial water meters are those fitted to pipes over 50mm in diameter. The UK market for water meters is predominantly driven by demand from UK water utility companies for billing purposes: Elster estimates that [most] of its residential water metering revenues derived from UK water utility companies in 2008. Elster considers that each of its competitors would also have a similar percentage of revenues from water utility companies.

Residential and C&I meters

6. The parties overlap in the supply of residential water meters. STMS does not supply commercial and industrial meters. Elster, however, supplies mechanical residential water meters while STMS supplies electronic residential water meters. The parties submitted that the relevant product market is the supply of residential water meters, this being consistent with the European Commission decision in CVC/Rurghas Industries[1] where the

[1] Case M.3874 CVC/Rurghas Industries

European Commission distinguished between the supply of residential water meters and commercial and industrial (C&I) water meters. The European Commission also further segmented residential water metres into utility water meters and sub-metering water meters.

7. While the OFT sees no reason to depart from the European Commission's analysis in CVC/Rurghas, for the purposes of this decision it is not necessary for the OFT to conclude whether residential and C&I meters belong to distinct markets, given that the competitive assessment of the merger is the same in either event.

Utility water meters and sub-metering water meters

10. Sub-metering is typically used in apartment blocks where separate meter readings are given to individual tenants for invoicing. The parties submit that sub-metering is predominantly found in continental Europe and that sub-metering in the UK accounts for less than one per cent of the total number of units installed.

11. While the OFT sees no reason to depart from the European Commission's analysis in CVC/Rurghas, for the purposes of this decision it is not necessary for the OFT to conclude whether a further segmentation between utility water meters and sub-metering water meters is required, given that the competitive assessment of the merger is the same in either event.

Mechanical and electronic residential water meters

12. Mechanical residential water meters are based on rotating piston technology. Elster is currently only active in the sale of mechanical meters in the UK and in the EEA. Elster residential water meters are designed to fit pipes of 15mm, 20mm, 25mm, 30mm and 40mm. Other companies that supply mechanical water meters in the UK and the EEA include Actaris, Sappel, Sensus and Arad.

13. Electronic residential water meters have no moving parts and operate through a complex flow tube which creates an oscillating movement in the water flow allowing for measurement using an electronic sensor. STMS is only active in the sale of electronic meters through their SmartMeter technology. SmartMeters are primarily designed for use with 15mm and

20mm pipes. Only STMS is active in the supply of electronic water meters in the UK and EEA.

14. The OFT has considered whether, because of their differing characteristics, mechanical and electronic water meters belong to distinct product markets. Table 1 indicates the differences in characteristics between electronic and mechanical water meters and respective advantages and disadvantages:

Table 1 – characteristics of mechanical and electronic water meters

Characteristics	Electronic	Mechanical
moving/static parts	• electronic water meters have no moving parts • less likely to jam due to particles in the water (so they are particularly advantageous in areas such as the Middle East where the quality of the water is not as good) • accuracy of the meter will not change with age or consumption • do not record air	• mechanical water meters do have moving parts • under-register with age and consumption • record air as water and so do not detect water leakage • may be more accurate with low volumes of water
electronic/mechanical calculation	• meter readings are calculated electronically • provide for features such as leakage alert signalling • direct digital output for energy management systems and radio transponders • cannot be tampered with • better platform for future smart developments including built-in radio transponders or data loggers	• meter readings are calculated mechanically • possible to tamper with • can provide a pulse output that can be read with automated meter reading (AMR) technology

whole life costing	• meter lifespan is limited by batteries which last ten to 15 years, but can then be replaced at a lower cost to the meter itself • disposal cost is higher as goods with a battery incur a disposal cost	• do not require a battery replacement • in general mechanical meters will need to be replaced approximately after 15 years • residual recycling value for meters so easier to dispose of
price	• more expensive[2]	• cheaper
AMR compatibility	• electronic meters are AMR enabled – one competitor [ ] indicated for data security and accuracy reasons AMR would work better on electronic meter. This view was not confirmed by customers or other competitors [ ].	• AMR component is additional

Source: OFT market investigation

15. On the basis of the table, electronic water meters appear to be better suited to use in areas where a high concentration of sand (or other particles) in the water results in the rapid degradation of mechanical water meters. Set against this, they are two to three times the price. On balance, therefore, the OFT's market investigation revealed a mixed view from customers and competitors: most water companies only use mechanical water meters and some would not even consider switching to electronic water meters as they view mechanical meters as superior, for use in the UK at least.

16. A review of the bidding data provided by the parties, as well as responses by third parties [ ], indicates that electronic meters are significantly more expensive. In the instances where Elster and STMS have bid together in the past, we observe that the STMS electronic meter bid was between [ ] and [ ] times as high as the Elster bid. However, electronic meters would not

[2] Although note that the lifetime cost need not be as expensive. [ ]

necessarily be more expensive than mechanical meters over the lifetime of both as electronic meters appear to have a longer life span. It is further apparent from the bidding data provided by the parties that customers do not appear to distinguish between mechanical and electronic water meters: in particular, customers (at least in recent years) formulate their tenders in a way that can be fulfilled by both mechanical and electronic water meters. Lastly, the only supplier of electronic water meters in the UK, STMS, directly competes with suppliers of mechanical water meters and has previously won a contract to supply Severn Trent Water, that (until recently) dual sourced mechanical water meters from Actaris and electronic water meters from STMS further to a competitive tender process.[3]

17. On the basis of the above, while it is not clear that all other customers would switch to electronic meters in the event of a small but significant increase in the price of mechanical water meters, the OFT assesses the merger on the cautious basis that both mechanical and electronic residential water meters are in the same market.

AMR technology

18. All residential meters have visual read capacity, that is, the water consumption reading can be checked by sight. Visual water meter reading is typically done in situ by an employee of the relevant water utility.

19. AMR technology allows meters to be read electronically and is normally supplied by the same companies that supply water meters.[4] There are two types of AMR technology: the newer AMR-RF technology that uses radio transmitters to send data to a handheld device or static GPRS receiver; and the older electronic meter reading (EMR) technology which uses 'touch read' systems, where the readings are taken at the meter site with an electronic hand-held device. The main difference between the two technologies is that AMR-RF can be used remotely.

20. The vast majority of the residential water meters supplied in the UK are AMR enabled that is, the meters have the facility to connect either to an EMR device or an AMR-RF transmitter.

[3] Severn Trent awarded the contract for the supply of water meters to STMS in an open tender process, as it is obliged to do under European public procurement rules.
[4] Although this is not necessarily the case, see paragraph 52

AMR technology as part of residential water meters market

21. From a demand side perspective, the OFT has considered whether it is appropriate to define some form of composite market for residential water meters plus AMR technology, given the latter is only ever purchased as a result of having purchased the former. The form of any such composite market will depend on how complementary water meters and AMR are. If competition in water meters feeds through into significant competitive constraints in the supply of AMR, then it may be appropriate to define a unified market for both (known as a 'system market'). Alternatively, if the products available to AMR customers are somehow restricted through their choice of water meter (e.g. because of technological compatibility), then it may be appropriate to define a market for water meters and separate markets for each type of AMR associated with each type of meter (known as 'multiple markets'). Conversely, if AMR technology is generally compatible with all water meters, then it may be appropriate to define separate markets for all water meters and for all AMR (known as 'dual markets').

22. In this respect, the OFT notes that, despite the fact that the large majority of water meters currently installed in the UK are AMR enabled, meter reading is still predominantly visual. Further, the OFT received no evidence that, when tendering for water meters, customers care sufficiently about the whole lifetime cost of the meter and the AMR to affect their choice of meter. These facts suggest that the complementarity between water meters and AMR is not strong enough to warrant a system market definition.

23. In respect of technological compatibility, the parties have submitted that in general it is possible to connect any AMR system to any water meter and most customers have confirmed this point. An exception is [ ]. The parties have submitted that STMS wall pads should be compatible with all meters. However, [ ].

24. The OFT further notes that recent water company tenders specify that tenders will be considered for (a) residential water meters only; (b) AMR devices; or (c) both for AMR and residential water meters. However, the OFT's market investigation has revealed that—although they are not compelled to for reasons of compatibility, water companies would nonetheless still prefer to source AMR technology from their water meter

supplier.[5] On this basis, a 'dual market' definition of separate markets for water meters and AMR appears more appropriate than a 'multiple market' definition ([ ]).

AMR-RF versus EMR technology

25. The OFT has considered whether there may be separate markets for AMR-RF and EMR technology. On one hand, both fulfil the same basic purpose; to facilitate automated meter readings which can then be easily fed into water companies' billing system. In addition, it appears that water companies' tender requirements for AMR could be fulfilled by either AMR-RF or EMR, meaning the technologies may exercise some constraint on each other. On the other hand, however, the OFT notes that there appears to be an imminent industry shift to AMR-RF with several water companies trialling these systems, which would seem to imply that the constraint on AMR-RF from EMR would be limited.

26. Given the nascent state of AMR-RF technology and the low take up of EMR, it is difficult to draw many conclusions as to the product scope from the market investigation.[6] However, the OFT's overall assessment will not change should the market be segmented into AMR-RF technology and EMR technology and so the OFT has not concluded on this issue.

Boundary Boxes

27. A boundary box is a simple polymer tube used to house water meters. STMS manufactures and supplies a range of boundary boxes but Elster is not active in the manufacture and supply of boundary boxes. The parties have submitted that boundary boxes are supplied independently from water meters and are not really complementary to them (in the sense of the 'system' and 'multiple' market approaches to market definition discussed above). Third parties have not raised any concerns in respect of the acquisition of the boundary boxes business of STMS by Elster or regarding any potential for non-horizontal effects arising out of the merger in this respect. The OFT will not therefore further consider boundary boxes any further in its competitive assessment.

[5] With the exception of [ ]. This is dealt with separately below.
[6] Even though this technology has been in use for a number of years, Elster estimates that only [ ] percent of the total UK installed meter base is fitted with an EMR system.

Prepayment Water Meters and Wireless Remote Shut-off Systems

28. The OFT has also considered whether a separate market exists for prepayment water meters and/or wireless remote shut-off systems. Pre-payment water meters allow the supply of water only when an up-front payment has been made. Once the credit has been used, the supply of water stops and the consumer has to purchase further credit to re-start it. Wireless remote shut-off systems are a type of pre-payment system that use a wireless remote shut-off valve which can be opened or closed remotely by the water utility company via a wireless network (for example, GPRS). Instead of buying payment cards or tokens for credit, the consumer pays the water utility company directly; in the event of non-payment, the water utility company is able to shut off the water supply remotely.

29. The OFT's market investigation has indicated that the supply of prepayment water meters and wireless remote shut-off systems is an emerging market internationally. However, the parties, DEFRA[7] and Ofwat have told the OFT that in the UK, prepayment water meters are illegal under section 63A of the Water Industry Act 1999, which prohibits the use of any 'limiting device' on water supplies to private dwelling houses. Consequently there are no sales of these systems in the UK. In addition, there are no indications that the prohibition on the installation of residential prepayment water meters is likely to be lifted in the short term. For this reason, the OFT does not need to conclude on the product scope of prepayment water meters or wireless remote shut-off systems and will not therefore consider these any further in its competitive assessment.

Conclusion on product scope

30. On the basis of the above, the OFT considers that the relevant product market in this case is that for the supply of residential water meters.

31. The OFT has also considered whether the constraints from the 'primary' water meter market to the 'secondary' AMR market may be strong enough to warrant defining some form of composite market over both (in particular given [ ]) but has concluded that the impact of the merger on AMR technologies is best assessed separately.

[7] Through the independent Review of Charging and Metering for Water and Sewerage services committee (commissioned by DEFRA)

Geographic scope

32. The parties submit that the relevant geographic market is the EEA. They argue that this is consistent with the European Commission decision in Ruhrgas where it was noted that (a) the Measurement Instrument Directive[8] (MID) although not yet fully implemented in 2005 had accelerated common technical standards in the EU; and (b) there are significant cross-border sales in Europe. The parties also submit that the MID has been implemented in a range of European countries ensuring the same standards and approvals for imports and domestically manufactured meters across Europe and that the new European water meter standard EN14154 is harmonised with the existing international standards ISO 4064 and OIML R498 which, in conjunction with the Mutual Acceptance Agreements,[9] are likely to lead to more imports into Europe.

33. While the OFT's market investigation did not contradict the points raised by the parties, as in the Rurghas decision, local presence appears to have some importance especially for technical support and reputational reasons, given that the parties' customers are predominantly public utility companies. In addition, on an EEA basis, there appear to be additional competitors which are not currently active in the UK. Taking a conservative approach, therefore,[10] the OFT has analysed this merger on the basis that the geographic market for residential water meters and for AMR technology is no wider than the UK.

HORIZONTAL ISSUES

Unilateral effects in respect of residential water meters

34. The parties overlap in the supply of residential water meters in the UK. The parties have provided market share data for the supply of residential water meters in the UK by installed base; by contracts (number and value) won over the past five years; and by revenue. The parties have also provided bidding data and examples of customers switching supplier. Given the lumpy nature of this market (meaning short term fluctuations in market

[8] Directive 2004/22/EC of the European Parliament and of the Council of 31 March 2004, O.J 2004 L 135, 1-80

[9] These harmonised standards allow non-European manufacturers to gain product approval under national legislation (based on either ISO 4064 or OIML R49) and then to apply for back-to-back MID approval using a Mutual Acceptance Agreement.

[10] The OFT has obtained data on an EEA basis and is satisfied that a narrower geographic market definition would raise more concerns than a wider geographic market definition.

shares can be dramatic as large contracts are won and lost), the relatively small number of contracts involved as well as the fact that some volume is not sold through a tender process but directly to water companies,[11] the OFT has examined the parties' competitive strength on all of these different bases.

Market shares by installed base

35. Table 2 illustrates the market shares of the parties and other competitors active in the UK by volume and value in respect of the installed base of residential water meters:

Table 2: Total supply of residential water meters in the UK[12]

	2008			
	Volume (units)	**Market share (%)**	**Value (£)**	**Market share (%)**
Elster	[ ]	45-55	[ ]	45-55
Target assets	[ ]	0-10	[ ]	0-10
Combined	[ ]	**45-65**	[ ]	**45-65**
Arad	[ ]	0-10	[ ]	0-10
Hydrometer (Sappel)	[ ]	5-15	[ ]	5-15
Itron Actaris	[ ]	10-20	[ ]	10-20
Sensus	[ ]	10-20	[ ]	10-20
Others	[ ]	0-10	[ ]	0-10
	[ ]	100	[ ]	100

Source: parties

36. The parties argue that 2008 market shares by installed base are significantly overstated and do not reflect the current and future market position of the parties because the contract that STMS had with Severn Trent Water for the supply of residential water meters was terminated in

[11] Elster submitted that approximately [0-10] per cent of UK residential water meter supplies are made outside of the tender process. The OFT is aware of at least one water company that purchases outside the tender process due to the fact that its requirements do not exceed the thresholds of the EU procurement rules [ ].
[12] The data comprises water meters supplied to fit water pipe sizes of 15mm to 40mm

November 2008. The parties have therefore provided restated market shares for 2008 to take account of this:

Table 3: Total supply of residential water meters in the UK (2008 restated)

	2008 (restated)			
	Volume (units)	**Market share (%)**	**Value (£)**	**Market share (%)**
Elster	[ ]	45-55	[ ]	45-55
Target Assets restated	[ ]	0-5	[ ]	0-5
Combined restated	[ ]	**45-60**	[ ]	**45-60**
Arad	[ ]	0-10	[ ]	0-10
Hydrometer (Sappel)	[ ]	5-15	[ ]	5-15
Itron Actaris[13]	[ ]	15-25	[ ]	15-25
Sensus	[ ]	10-20	[ ]	10-20
Others	[ ]	0-10	[ ]	0-10
	[ ]	100	[ ]	100

Source: parties

37. In addition, the parties have provided projected market shares for 2009 which also take account of the termination of the contract between STMS and Severn Trent Water. This is shown in Table 4:

[13] As Actaris now holds the Severn Trent Water contract in its entirety, the OFT has allocated the Target Assets' 'lost' sales to Actaris.

Table 4: Total Supply of Residential Water Meters in the UK (2009 forecasts)

	2009[14]			
	Volume Units	**Market Share (%)**	**Value (£)**	**Market Share (%)**
Elster	[ ]	40-50	[ ]	40-50
Target Assets	[ ]	0-5	[ ]	0-5
Combined	[ ]	**40-55**	[ ]	**40-55**
Arad	[ ]	0-10	[ ]	0-10
Hydrometer	[ ]	5-15	[ ]	5-15
Itron Actaris	[ ]	20-30	[ ]	20-30
Sensus	[ ]	5-15	[ ]	5-15
Other manufacturers	[ ]	0-10	[ ]	0-10
Total Market	[ ]	100	[ ]	100

38. The OFT notes that the increment in the restated market shares appears, prima facie, to be unproblematic, since when considering the re-stated 2008 data the increment in market share would be [0-5] per cent on a value basis.[15] However, in its recent decisions in Northgate/Anite,[16] Capita/IBS[17] and Spectris/Lochard[18] the OFT noted that such 'legacy' shares of the installed base may not accurately represent the dynamics of competition in markets characterised by tendering and bidding processes. The OFT noted in those cases that once a contract has been awarded, the opportunity for further competition in relation to that customer is limited until the contract (or part of the contract) is put out to tender again. Consequently, the OFT has therefore also examined the instances where the parties have interacted in competitive bid situations over the last five years.

[14] The parties submit that the contraction in overall market size reflects Elster's expectations that the number of new build houses and the number of people moving house will fall significantly in 2009 versus 2008 levels as these two events represent the main opportunities for water utility companies to install new residential meters. This has been confirmed by the OFT's market investigation [ ]

[15] The OFT would take into account the loss of the Severn Trent Water contract by STMS.

[16] ME/3795/08

[17] ME/3841/08

[18] ME/3911/08

39. The OFT notes that while water meter contracts are publicly tendered, they are not exclusive and the water companies do have the ability to purchase water meters from companies other than the one they have selected through the bidding process. There is no fixed number of meters that have to be purchased under these agreements but only small volumes of ad hoc supplies are made to water companies outside these major framework contracts. While the OFT notes the parties' submission that this lack of exclusivity creates the potential for additional competition during the period of the supply contract and does not limit competition to the point of tendering, there is no evidence that such intra-contract competition actually occurs. In particular, the OFT understands that the small volume of sales outside the framework contracts are from (a) smaller water utility companies that do not tender at all (for example, [ ]); and (b) the supply of particular residential water meters that are absent from the portfolio of the incumbent supplier. Consequently, the OFT has also examined the parties' combined competitive strength on other bases.

Bidding data

40. The parties have provided bidding data in the UK from 2003. The data indicates the identity of the bidders for each contract, the winner of each and the value of Elster's or STMS's bid, where either bid. The data is reproduced in Table 5.

Table 5: UK bidding 2003 to 2007

		Volume	**Elster's bid**	**STMS bid**	**Winner**
2008	Thames Water	[ ]	[ ]	[ ]	Elster
	Severn Trent Water	[ ]	[ ]	[ ]	Actaris
	South Staffordshire	[ ]	[ ]	[ ]	Actaris
2007	United Utilities	[ ]	[ ]	[ ]	Sappel
	Veolia	[ ]	[ ]	[ ]	Sensus
	Wessex Water	[ ]	[ ]	[ ]	Sensus
	Welsh Water	[ ]	[ ]	[ ]	Arad
2006	Anglian Water	[ ]	[ ]	[ ]	Elster
	Southern Water	[ ]	[ ]	[ ]	Elster
	Northumbrian Water	[ ]	[ ]	[ ]	Actaris
2005	Thames Water	[ ]	[ ]	[ ]	Elster
	South West Water	[ ]	[ ]	[ ]	Elster

	Wessex, Bournemouth & Hampshire	[ ]	[ ]	[ ]	Unknown
	South East Water	[ ]	[ ]	[ ]	Elster / Actaris
2004	Yorkshire Water	[ ]	[ ]	[ ]	Actaris
2003	Severn Trent Water	[ ]	[ ]	[ ]	Actaris / STMS
	United Utilities	[ ]	[ ]	[ ]	Elster
	Veolia	[ ]	[ ]	[ ]	Sensus
	South East Water	[ ]	[ ]	[ ]	Elster
	Wessex Water	[ ]	[ ]	[ ]	Sensus

Source: parties

41. From Table 5, the OFT notes: (i) in the last five years Elster bid for [ ] contracts and STMS for [ ]; (ii) in only [ ] of these contracts did both parties bid; (iii) during the past five years there have been at least four other companies that have been awarded contracts with water utility companies, namely Actaris, Sensus, Sappel and Arad. (This information is consistent with the OFT's market investigation where water utility companies have mentioned these four companies as effective competitors to the parties. See further below.)

42. There is nothing in the bidding data to suggest that the parties are each others' closest competitors – STMS has only bid [ ] times against Elster in 20 tenders over the past five years. Both Actaris and Sensus have won more bids against Elster than the number of times STMS has bid against Elster. Arad and Sappel have also won contracts against Elster whilst [ ].

43. The OFT also considered whether the transaction would result in the elimination of a firm that acts as a particularly strong competitive force in the market, regardless of the fact that its market share may be quite small. [ ]. In addition, the OFT's market investigation does not appear to indicate that the STMS electronic SmartMeter is particularly superior to the mechanical meters that are available from other competitors.

44. Set against this, the OFT notes the following statement in an Elster internal document regarding the rationale for the acquisition: [ ]

45. In this respect, the OFT notes, however the following: (a) customers did not appear to have a concern that the transaction would lead to increased prices; (b) a comparison of the bid prices shows that STMS prices were

significantly higher than Elster prices. Although the OFT understands that on a 'whole life costing' basis the STMS meters were priced competitively, it does appear that customers did not necessarily view the bids this way; (c) even though the OFT acknowledges that STMS may have been a constraint on Elster by just participating in the bidding process it notes that when looking at the bidding data (and taking into account comparable volumes) there appears to be no downwards price pressure on Elster when STMS put in a bid. In addition, the OFT notes that there are four other effective competitors – Sappel and Arad are new entrants that have managed to build up a presence over the past years. On balance, therefore, the OFT does not believe that STMS exercised any significant competitive constraint on Elster, despite the above-mentioned comments in Elster's internal documents.

Remaining competitors

46. The parties have submitted that the merged entity will continue to face a number of strong competitors that are all large, established, multinational companies. The parties pointed in particular to Sensus, Sappel, Actaris and Arad as all having capabilities to compete with the merged entity. The OFT's market investigation was consistent with these competitors being effective alternatives to the merged entity.

Switching

47. The OFT also considered whether there are significant switching costs for meter supply. As a preliminary point, once a meter is installed, it will need to be replaced approximately 10-15 years later (and, potentially even at a later stage) so it is for the installation of new meters that a water company may switch supplier. [ ], water utility companies have indicated that they would switch supplier and, in fact, the parties have provided the OFT with three examples of switching from 2006 to 2008, namely of Severn Trent Water (switching from dual supply by STMS and Actaris to single supply by Actaris), United Utilities (switching from Elster to Sappel) and Welsh Water (switching from Elster to Arad). Indeed, the fact that Severn Trent Water and South East Water dual supply (or at least used to dual supply) would indicate that switching water meter suppliers is not difficult.

[ ]

48. [ ].[19]

49. However, the OFT notes that [ ]. For this reason, the OFT considers that the impact (if any) of the merger on [ ] will be very limited, both in time and scope, and that any lessening of competition as a result of the merger will not be substantial. [ ]. However, the OFT has not needed to reach a definitive conclusion as to whether it is or may be the case that the merger may be expected to result in a substantial lessening of competition because - even if the duty to refer were triggered - the OFT would apply its discretion under section 33(2)(a) of the Act not to refer the merger to the Competition Commission given the very small size of the affected market (i.e. [ ]) in this instance.[20]

Conclusion

50. Overall, on the basis of the evidence received, the OFT does not consider that the transaction raises any unilateral effects concerns in respect of the supply of residential water meters in the UK.

Unilateral effects in respect of AMR technology

51. The OFT considers that AMR technology is still very much in the development stage in the UK.[21] This has been confirmed by the water companies (that are still largely in the process of trialling AMR) and by the Review of Charging and Metering for Water and Sewerage services committee that is currently preparing a report for water metering in the UK. The OFT views the assessment of market share data in the AMR context as an unsuitable method for the purposes of concluding whether the transaction would result in any substantial lessening of competition in the AMR market. What the OFT considers as more pertinent, is the fact that all major competitors have been named by customers as providing AMR technology at least on a trial basis. In addition, customers do not appear to consider the STMS product as one that has substantial benefits in terms of

[19] [ ]
[20] [ ]
[21] Despite the fact that EMR technology has been in use for a number of years, its take up has been limited as described above in paragraph 25.

AMR-RF (being an electronic meter). The view from competitors in this respect was mixed, that is, one competitor [ ] believed that electronic meters have some advantage in respect of AMR whereas another [ ] believed that this was not the case. Customers, however, did not view electronic meters as having an advantage over mechanical meters in terms of compatibility with AMR.

52. In addition, as far as AMR-RF is concerned, water meter companies face additional competition from firms that are active in radio technology, such as [ ]. The OFT's market investigation has revealed that [ ] has tendered for the AMR aspect of at least one water company's contract [ ]. The OFT therefore considers that there could be additional competitors in the AMR market.

53. On the basis of the above, the OFT does not view the transaction as resulting in a substantial lessening of competition in the AMR market – there are still at least four effective competitors with additional constraint being provided from radio technology companies.

COORDINATED EFFECTS

54. Mergers in markets such as the supply of water meters and meter reading technology where the process of competitive interaction is characterised by tendering and bidding may be subject to coordinated effects as the bidding process itself may increase transparency and because repeated interactions in terms of contract tenders may offer a credible punishment mechanism. Conversely, collusion is less likely to occur in markets such as these where outcomes are 'winner takes all', and where contract interactions are lumpy (that is, irregular, infrequent and of greatly varying value) and irreversible (that is, once a contract is awarded, there is no further competition for that customer). In respect of this second point, the OFT notes that there is some scope for competition once the contracts are awarded, since the water companies do not generally enter into exclusive agreements with the water meter companies.

55. The OFT considers that there are three cumulative conditions that must all be met for a merger to create or strengthen coordinated effects: (i) firms need to be able to reach and monitor the terms of coordination; (ii) coordination must be internally sustainable; and (iii) coordination must be

externally sustainable. Further, for coordinated behaviour to take place as a result of a merger, the merger must strengthen pre-existing coordination or make coordination more likely. The levels of concentration post merger (that is, there will be five competitors active on the relevant markets) and the terms of the contractual arrangements (that is, the fact that individual contracts vary greatly in value) would lead the OFT to the conclusion that at least the first condition for finding coordinated effects is not satisfied. In addition, the OFT's market investigation, raised no concerns in relation to any coordinated effects in the supply of residential water meters or AMR technology. On the basis of the evidence before it, the OFT does not consider that there is a realistic prospect of the merger creating or strengthening coordinated effects.

BUYER POWER

56. Responses to the OFT's market investigation indicate that water companies generally consider that they enjoy some degree of buyer power and negotiating strength. [ ]

THIRD PARTY VIEWS

57. Third party views have been discussed above where appropriate. Third parties largely confirmed the account of the market expressed by the parties in the submission. No third party customers or competitors expressed concern about the transaction, with the exception of [ ].

58. In addition, a third party [ ].

ASSESSMENT

59. The parties overlap in the supply of water meters and AMR technology in the UK. In addition, [ ].

60. For the purposes of its assessment, the OFT analysed the merger on the basis of the supply of water meters and, separately on AMR technology in the UK. In doing so, the OFT considered the specific concerns of [ ]. The OFT did not find it necessary to conclude on the scope of the relevant

product and geographic markets since the outcome of its competition assessment does not vary according to the market definitions used.

61. The merger will reduce the number of market participants supplying water meters and AMR technology from six to five. The OFT is satisfied that the merger will not result in any unilateral effects in respect of the supply of water meters as the increment in market shares is very small and the evidence suggests that the parties are not each others' closest competitors. In respect of AMR technology, the OFT has found that this is still a developing market in the UK and that since all current water meter competitors have developed AMR technology (as well as additional competitors that can provide AMR-RF technology going forward) there will be no unilateral effects arising out of the merger.

62. In respect of [ ] the OFT considered that even though there could be some impact on competition [ ], this would not be substantial in both time and scope. This is because [ ]. However, the OFT did not need to reach a definitive conclusion on this issue as - even if the duty to refer were triggered - the OFT would apply its discretion under section 33(2)(a) not to refer the merger to the Competition Commission given the very small size of the affected market ([ ]) in this instance.

63. The OFT's market investigation did not generally reveal any concerns in respect of the merger from water utility companies, with the exception of [ ].

64. In light of the above, 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

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