

Completed Acquisition by Capital Group plc of IBS OPENSystems plc

ME/3841/08

The OFT's decision on reference under section 22(1) given on 19 November 2008. Full text of decision published 10 December 2008.

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

**PARTIES**

1. **Capita Group plc** (Capita) operates in the business process outsourcing sector and provides a full range of support services comprising back office business, processes, customer contract services, administration and support, human resources, information technology, property and infrastructure consultancy, finance, treasury and shareholder services and management and property consultancy. A business division of Capita, Capita Software Services, supplies revenues, benefits, payment management, e-government and integrated housing management systems within the public sector and social housing marketplace.
2. **IBS OPENSystems plc** (IBS) provides software and supporting services to local authorities and housing organisations throughout the UK. Its services comprise: the provision of housing management solutions, revenues and benefits solutions, works management solutions and solutions facilitating control of all key financial tasks to create an organisation-wide total management solution.

## **TRANSACTION**

3. On 26 June 2008 Capita's offer for the entire issued share capital of IBS was declared unconditional in all respects and completed on the same date. The Office of Fair Trading (OFT) sent an enquiry letter to Capita on 21 August and in response Capita made an informal submission to the OFT on 15 September 2008. The four month statutory timetable (as extended) expires on 20 November 2008.

## **JURISDICTION**

4. The OFT believes that as a result of this transaction enterprises have ceased to be distinct for the purposes of the Enterprise Act 2002 (the Act). In one of the areas of overlap between the parties – the provision of revenue and benefits applications and related services to local authorities in the UK – the parties' estimated combined share of supply is in excess of 25 per cent. The share of supply test in section 23 of the Act is therefore satisfied. Therefore the OFT believes that it is or may be the case that a relevant merger situation has been created.

## **MARKET DEFINITION**

### **Product Scope**

5. The parties overlap in the provision of IT solutions to government agencies and housing organisations. In particular, they overlap in the provision of revenues and benefit software services to local authorities (referred to in this decision as R&B software services) and the provision of housing software services to local authorities, ALMO's (arm's length management organisations) and housing associations (referred to in this decision as SH software services).
6. R&B software is developed for the back office management of the calculation of council tax and domestic rates, the calculation of business rates, the calculation of housing and council tax benefit and the administration and billing/payment of each. Related services which suppliers typically offer include management of the implementation of the project, training and consultancy services.
7. SH software applications are used for the management of social housing stock. The software enables users to calculate rent and service charges

and generate bills, to manage the repairs and maintenance of tenancy dwellings, to allocate homes and to manage tenant communications and advice provided. Related services include management of the implementation of the project, training and consultancy services.

8. Capita submitted that the supply of R&B software services and the supply of SH software services should be considered as separate product markets.
9. The proposition that R&B software services is a separate product market is consistent with the OFT's decision in *Northgate / Sx3*<sup>1</sup> and also its more recent decision in *Northgate / Anite*.<sup>2</sup> Within R&B software services, although there are separate modules for council tax, business rates and housing and council tax benefits, those modules are, in the majority of cases, bought by local government authorities as one package and supplied by a similar subset of companies.
10. In relation to SH software services, Capita submitted that the relevant product market for housing software services would comprise all packaged offerings of lettings, rent and arrears as these are commonly supplied as a package by a single provider. They also note that conditions of competition in this sector are distinct from those in the R&B sector, for example by virtue of differing legislation and as discussed below, the number of competing products.
11. In its recent decision in *Northgate / Anite*, the OFT acknowledged some degree of demand and supply side substitutability in the provision of software and related services to local authorities and housing organisations, but considered the appropriate frame of reference to be the provision of R&B software services and, separately, the provision of SH software services. The OFT has concluded that it is appropriate to adopt a similar approach in this case.

### **Geographic scope**

12. Capita submitted that the relevant geographic scope for both R&B and SH software services is the UK. This is consistent with the OFT's decisions in *Northgate / Sx3* and *Northgate / Anite*. Capita noted, however, that these sectors would need only minimal modification to function for customers

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<sup>1</sup> *Completed acquisition by Northgate Information Solutions plc of Service and Systems Solutions Ltd 5 May 2005.*

located in the Republic of Ireland, as customers located there can be easily serviced from the UK without an additional language functionality needed to be built into the system.

13. Focusing on UK customers, and on a cautious basis, and following the approach adopted in Northgate / Anite, the OFT considers it appropriate to examine each of the above product markets on a UK wide basis.

## **SUPPLY OF R&B SOFTWARE SERVICES**

### **Unilateral effects**

#### Background

14. R&B software services contracts are subject to formal two stage bidding processes. Generally, market participants are invited to tender an initial up front bid. Preferred bidders are then invited back to a second phase negotiation process where the exact scope and terms of service and payment are negotiated. Based on third party comment, the OFT understands that in the majority of cases two participants are invited to negotiate contracts at the second phase, although this will not always be the case and in some instances there may be only one participant in the second phase negotiations.
15. Payment for services takes the form of an initial up front payment for the software purchase, a payment in relation to implementation of the project paid over the period of implementation (generally 12 months) and an on-going element for service and support. Capita stated that the price for ongoing support services is essentially locked in to the initial contract subject to indexation for future years. The OFT is also aware that R&B software services are linked closely to the relevant legislation which is updated and amended on a regular basis. It is therefore contractually required that suppliers update their products periodically to ensure they satisfy legislative requirements. Notwithstanding this, the OFT is aware that there are other elements of the non-price offering that are discretionary and independent of legislative amendments/protocols.

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<sup>2</sup> *Anticipated acquisition by Northgate Information Solutions UK Limited of Anite Public Sector Holdings Limited 27 October 2008.*

16. Capita further noted that, in general, contracts are negotiated for an initial term of five to ten years but that in practice contracts roll over on an annually renewing basis for a significantly longer period after the initial term. This is due to the significant up-front costs payable for the initial software licence. Capita submitted that customers will generally only go out to market for new software when either (i) a systematic failure of service occurs in relation to the incumbent provider, (ii) there is a major technological change justifying movement to a new system, or (iii) there is a particularly fundamental change to legislation (above and beyond the normal amendments).

#### Shares of supply of legacy contracts

17. There are a limited number of providers of R&B software services in the UK, two of which historically included Northgate Information Solutions UK Limited (Northgate) and Anite Public Sector Holdings Limited (Anite). Following OFT clearance of the anticipated acquisition by Northgate of Anite on 27 October 2008, it was announced that this transaction completed on 3 November 2008 with the result that, for the purposes of the OFT's assessment of this transaction, Northgate and Anite are now merged.
18. Capita provided market share data for the supply of R&B software services to local government in the UK.<sup>3</sup> The OFT is aware that on this basis the parties' share of supply for the installed or legacy base of contracts being serviced is [35-45] per cent (increment of [10-20] per cent). Other players in this market are Northgate / Anite (combined [40-50] per cent) and Civica ([0-10] per cent).
19. In its recent decision in Northgate / Anite, the OFT noted that such installed or legacy shares (that is, contracts which are already in place) are unlikely to represent the best measure of current competitive conditions in the R&B market.
20. The OFT is aware that, once a contract has been awarded, the opportunity for further competition for R&B applications or services in relation to that

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<sup>3</sup> Based on volume figures provided by the Society for Information Technology Management. These figures are materially consistent with those set out in the OFT's decision in Northgate / Anite.

particular customer is in practical terms extremely limited until the contract is put out to tender again. Further, given the length of the contracts negotiated (five to 10 year initial terms with the potential for indefinite annual roll-on) the OFT considers it likely that market shares estimated on a legacy basis would offer a distorted picture of the present strength of competitive constraints, as such legacy shares would reflect competition that happened some time in the past.

21. The potential effects of the merger on legacy contracts is discussed further at paragraphs 40-47 below.

Shares of supply of newly tendered contracts

22. On the basis of the above, the OFT considers that the set of data which relates to newly tendered contracts within the last five years offers the best measure of recent competitive interactions.
23. Shares of supply based on the number of new tenders won per annum as identified by the parties since 2003 are set out in Table 1 below.

**Table 1: Number of contracts won (2003 – 2008)**

|                        | 2003 |     | 2004 |     | 2005 |     | 2006 |     | 2007 |     | 2008 YTD |     |
|------------------------|------|-----|------|-----|------|-----|------|-----|------|-----|----------|-----|
|                        | No   | %   | No       | %   |
| Capita                 | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| IBS                    | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| <b>Capita/IBS</b>      | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| Northgate              | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| Anite                  | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| <b>Northgate/Anite</b> | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| Unknown                | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |
| <b>Total</b>           | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]  | [ ] | [ ]      | [ ] |

Source: Capita

24. On the basis of these figures the OFT considers that the parties have a volatile, but nevertheless consistently significant, share of newly tendered contracts, with Capita winning on average [40-50] per cent of contracts and IBS winning an average of [20-30] per cent.
25. With regard to the frequency of competitive interactions, a comparison of Capita and IBS' bidding data (from 2005 until May 2008) shows that: (i) Capita and IBS bid against each other in the vast majority cases, (ii) one of the two parties was successful on most ([70-80] per cent) occasions when the parties tendered (Capita [ ] and IBS [ ] out of a total of [ ] in the

last three years), (iii) Northgate is a considerably stronger competitor to both parties relative to other market participants, and (iv) other market participants such as Anite and Civica were far less successful in bidding for contracts over the same period.

26. With respect to the competitive constraint placed on Capita by IBS and vice versa, the parties submitted that they were shortlisted against one another in only [20-30] per cent of identified bids. Capita suggested this to be evidence that the weight of constraint placed by the merging parties on each other is low relative to that of other market participants. The OFT however considered there to be some uncertainty as to the evidentiary weight that can be placed on this figure for several reasons. First, it is not always clear when suppliers are participating in the second round of a formal tender process or when they are simply engaged in more informal negotiations. Second, as stated in paragraph 14 above, all tenders do not necessarily result in a shortlist of two bidders, meaning that the figure presented by Capita may implicitly underestimate the degree of competition between the parties. Third, the OFT was not able independently to verify the identity of the alternative short-listed bidder in the remaining [70-80] per cent of cases. Fourth, the parties did not offer any explanation as to the divergence between the competitive position implied by this figure and that implied by their combined [50-60] per cent share of recent bids (see paragraph 23 above). Overall, then, the OFT considers that this figure in isolation is not sufficiently reliable evidence of the competitive constraints the parties impose on one another.

#### Remaining competitors in the market

27. The OFT notes Capita's submissions that the merged entity will continue to offer the software solutions of both Capita and IBS to customers going forward during competitive tender until such time as there is a technological or major legislative change. Such a strategy will, however, not act to mitigate any competition effects that may arise from the merger as, pre merger customers would have a choice of two independently operating suppliers, whereas post merger, customers would have the choice of only one of these suppliers, albeit with two separate product offerings.
28. Capita argued that the remaining competitors in the market (Northgate/Anite and Civica) offer an effective competitive alternative to the parties.

29. Capita submitted that Northgate is the principal competitor in the R&B software services market, and that its product has technical advantages over either of the products supplied by the merging parties. Capita considers that Northgate's recent acquisition of Anite is likely to increase Northgate's competitive strength as the acquisition provides Northgate with a captive customer basis which will increase its ability to win new contracts in coming years. Specifically, Capita argued that Northgate will be able to establish effective relationships with current Anite customers through its support and maintenance function and will be well placed to supply them with a replacement Northgate system, without the contracts ever being put out to tender.
30. Capita submitted that Civica is a longstanding competitor in the market for R&B software services and that 3i Investments plc's recent acquisition of Civica would give Civica access to substantial capital for business development. Capita also stated that the Civica product has received good ratings and therefore has good referenceability.
31. Broadly, third party evidence was consistent with the view that Northgate was a significant competitor to the parties, and that its share of newly tendered contracts may be reasonably large. Third parties did not indicate, however, that the pre-merger competitive constraint of IBS on Capita was significantly less than that of Northgate. The OFT considers that this characterisation is consistent with the bidding data presented by the parties. By contrast, third party responses did raise serious questions in relation to Civica's position in the market, highlighting its limited intentions with regard to competing for new work and perceived shortcomings in the quality of the product on offer which would require significant investment. The OFT has no evidence on which to conclude that Civica is likely to present an increased competitive constraint in the future. [REDACTED].
32. Overall, on the basis of the evidence before it, the OFT does not consider that the competitive constraints which remain in the market after this merger will be sufficient to constrain the merged entity such that there can be no realistic prospect of a substantial lessening of competition resulting from the removal of IBS as an independent competitor.

#### Future contracts going out to tender

33. Capita argued that there has been a dramatic reduction in the number of contracts put out to tender and that eight contracts are expected to be put

out to tender in 2009. Capita submitted that this means that every market player must compete even more aggressively to increase its chances of winning new business.

34. Capita further noted that the large majority of customers that have gone out to tender have been Anite customers unhappy with the performance of its Pericles system. This may give rise to the argument that fewer customers will go out to tender in the future if Northgate is able to migrate Anite customers onto its own products without the need for a competitive tender process following the merger between these two providers. In addition, Capita stated that the number of contracts going out to tender is reduced by reason of the formation of unitary authorities<sup>4</sup>. Both these factors would further accentuate the fierceness of competition for those contracts that are actually put out to tender.
35. In taking a view on these arguments the OFT is aware that the scale of any individual contract is low relative to the overall revenues generated by the parties in this market. For example based on value estimates of recent contracts, the OFT estimates that the average tender is worth approximately [ ] per cent of IBS' annual turnover. On the basis of this evidence it would not seem plausible to characterise this market as 'winner takes all' or to conclude that the incentives of market participants to compete for new work are sufficiently heightened to a level to mitigate the unilateral effects concerns raised above.<sup>5</sup>
36. The OFT accepts that the number of R&B software services contracts that it can confidently be predicted will be out to tender in the short term is limited, however, it cannot be ruled out that this situation may change going forward. Although some customers will be subject to a fixed term contract, the OFT understands that a large number of contracts are rolled over, and as such are potentially available for re-tender. In addition whilst the OFT has little evidence of customers switching, or threatening to switch contracts other than Anite or Civica customers, the OFT cannot rule out that higher levels of tendering could occur going forward by reasons of technological or legislative change, or because of a significant change in quality of performance by one or more suppliers.

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<sup>4</sup> A unitary authority is local authority that has a single tier and is responsible for all local government functions within its area.

<sup>5</sup> *Kemplerer, P. (2005) Bidding Markets defines a true bidding market as one in which competition is winner takes all.*

37. Such technological developments or a major change in legislation could occur, for example, as a result of a change of government and subsequent amendments to the revenue and benefits structure.<sup>6</sup>
38. Finally, even though the focus of the OFT's concerns centres on future contracts for the supply of R&B software services, it is also concerned about the impact of the merger on suppliers' incentives to innovate going forward, which will impact on the whole of the customer base.
39. For these reasons, the OFT cannot rule out the prospect of a substantial lessening of competition arising on the basis that there are too few contracts coming up for renewal in the short term for concerns to arise.

#### Impact of competition on legacy market – threatening to switch

40. The OFT considered whether there is any prospect that customers with existing legacy contracts could benefit from competition in relation to new contracts simply by threatening to switch. Such a benefit would be likely to be felt by way of improved ongoing service and maintenance offering rather than by price (which is determined at the outset of the contract).
41. In assessing this argument the OFT considered a number of factors, namely:
  - i. the extent to which incumbent suppliers were in any event constrained in relation to their (PQRS)<sup>7</sup> offering by regulatory requirements, and
  - ii. the extent of evidence of actual switching or of customers threatening to switch to extract improved PQRS terms from suppliers.
42. In relation to the first point, Capita submitted that a significant proportion of suppliers' non-price offering is constrained by legislative factors, and that in view of constantly changing regulatory structures, there is a necessary requirement for suppliers to update and invest in products to ensure they meet legislative requirements. However, whilst the OFT accepts that a number of dimensions of the non-price product offering are constrained by legislative issues, it cannot rule out that there remain

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<sup>6</sup> For example, Capita stated that it expects that: [ ]

<sup>7</sup> Price, quality, range and service.

material areas of discretion for suppliers in terms of the quality of ongoing service and support that they provide.

43. With regard to the latter point, Capita submitted that [ ] customers had extended their contracts without going out to tender. It stated that this was a result of its quality of service and because of the substantial up-front costs involved in switching suppliers. Based on the evidence gathered by the OFT, the large majority of customers going out to tender have been, and now are, those switching from Anite's Pericles product or Civica's product. They argue that such switching was a result of a complete failure of service standards, rather than evidence of customers switching to affect small improvements in non-price factors.
44. The OFT's calculations have confirmed Capita's contention that the up-front cost of switching R&B software services is significant relative to the on-going cost of service. Accordingly, any loss in quality of service on an ongoing basis is likely to have to be very significant for a customer to switch suppliers. Further, the OFT has received no evidence of customers actually switching in response to a diminishment of service quality.
45. There is therefore no basis on which to conclude that the threat of switching is sufficiently plausible or significant that current competition in the market for contracts going out to tender has a material impact on service levels provided to legacy contract customers.

Impact of competition on legacy market – indirect benefit on service quality

46. The OFT considered also whether customers on legacy contracts could benefit indirectly from competition for other contracts being tendered. This could take the form of suppliers having an incentive to provide higher levels of service to legacy customers in order to enhance their reputation in the market and therefore increase their prospects of winning new tenders. This would occur to the extent that new customers made their choice of supplier based in part on the way that suppliers treated their legacy customers. In this case, any loss of competition for contracts going out to tender could give rise to second degree unilateral effects concerns on the total market.
47. Although this theory is plausible, the evidence before the OFT does not indicate that competition in the contestable market does in fact serve to protect service levels for legacy customers in this way. First, the evidence

before the OFT tends to suggest that reputational issues focus more on actual product design and reliability than on ongoing service levels. Second, customer user groups (discussed in detail in paragraphs 87 and 88 below) provide a more direct mechanism for legacy customers to put pressure on their current supplier. Third, the OFT has seen no evidence to suggest that customers appointing a new supplier do so on this basis.

#### Conclusion on unilateral effects in R&B software services

48. On the basis of the evidence before it, the OFT's concern is that post-transaction the merged entity would face a significantly reduced constraint on its competitive behaviour such that it would have the ability to raise price, and/or reduce non-price factors (such as service quality or innovation which is unrelated to regular changes in the legislation) in relation to future contracts for the supply of R&B software solutions.
49. The OFT notes particularly the bidding data provided by Capita which indicates that the parties account for a consistently high proportion of newly won contracts and that few constraints will remain post-merger, which in itself may give rise to unilateral effects concerns. The OFT is not persuaded that the shrinking size of the market affects this conclusion.
50. A large number of customers have expressed concern about the merger in that a reduction in the number of effective competitors would materially affect their ability to negotiate better terms. Some expressed concern that they would face a restricted supplier environment and would likely experience a reduction in buyer power.
51. In accordance with this assessment, the OFT believes, on the balance of probabilities, that the merger will likely result in a substantial lessening of competition in relation to future contracts for the supply of R&B software services to local authorities in the UK as a result of unilateral effects. Barriers to entry and buyer power are considered below.

#### **Coordinated effects**

52. The OFT has also considered the likelihood of coordination in the market for the supply of R&B software services. In general the OFT considers that bidding markets may be subject to potential coordination problems as the bidding process itself may increase transparency and because repeated interactions in terms of contract tenders may offer opportunity for an

obvious, credible punishment mechanism. A transaction may be viewed as more likely to increase the likelihood of coordination when it reduces asymmetries between competitors within the market.

53. When assessing whether a merger will enhance the likelihood of coordination, the OFT must consider, first, whether the affected market is conducive to coordinated behaviour, and, second, whether the merger changes the competitive environment to make successful co-ordination more likely.
54. The OFT guidance refers to the three conditions that must be met or created by the merger for tacit collusion to be successful or for it to become more likely<sup>8</sup>: (i) ability to align behaviour, (ii) incentives to maintain the coordinated behaviour, and (iii) behaviour must be sustainable. Based on the information and evidence presently available to it, the OFT's assessment of the market for the supply of R&B software services in this respect is as follows.
55. The market is stable and mature in terms of the market participants, although there is a significant degree of fluctuation in shares of newly tendered contracts. The repeated bidding process is likely to increase transparency (although Capita argued that the market lacks transparency). The awarding of contracts via a tendering process and the repeated interactions between the parties in that context (that is, the probability of future competitive interactions via the next tendering process) could provide the market players with the ability to detect cheating and a credible punishment mechanism. This is enhanced by the relatively regular nature of contract tendering (although the annual number of new contracts is currently limited). As discussed below, the OFT considers that barriers to entry to this market are relatively high, and customers do not possess significant countervailing buyer power (see below for a separate discussion on buyer power).
56. Weighed against this is the fact that there is a substantial degree of heterogeneity between specific tenders. Further, contracts are formed of a number of constituent prices and a variety of non-price factors. The multi-dimensional nature of contracts and subsequent negotiations is likely to make it difficult for parties tacitly to collude by raising price or equivalently decreasing non-price factors on contracts for which they bid. With respect

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<sup>8</sup> OFT Mergers – Substantive assessment guidance, para 4.12.

to market sharing (that is, parties not competing for contract for which the other is the incumbent), the OFT notes that customers are relatively well informed and that contracts are regularly discussed at user groups and other forums. Such transparency is likely to render any such collusive practice obvious and therefore ineffective, particularly given the limited number of suppliers currently operating.

57. The second issue to consider is the extent to which the merger will of itself increase the likelihood of coordinated outcomes on this market. In taking a view on this matter it is relevant that, (i) the merger reduces asymmetries between the merging parties and their primary competitor (Northgate). The post merger market will in effect be a duopoly of supply, and (ii) the bidding data presented by Capita indicates that the merging parties are vigorous competitors.
58. The OFT has received no evidence that tacit (or explicit) coordination occurred in this market pre-merger. Further, whilst noting the significant impact of the merger on market structure, the OFT believes that the characteristics of the market are such that any resulting competition concerns are more likely to arise in a unilateral manner rather than through tacit coordination. However, given the OFT's conclusions that the merger gives rise to likelihood of a substantial lessening of competition for future contracts based on unilateral effects, it has not needed to rule out the possibility of tacit coordination arising as a result of the merger.

## **SUPPLY OF SH SOFTWARE SERVICES**

### **Unilateral effects**

59. In respect of the supply of SH software services to local authorities, ALMO's and housing associations, share of supply estimates presented by Capita with respect to legacy contracts for SH software services are set out in Table 2 below.

**Table 2: SH software shares of supply of legacy contracts**

|            | Share by number of installations<br>(per cent) |
|------------|--|
| Northgate  | [ ]  |
| SDM        | [ ]  |
| Orchard    | [ ]  |
| IBS        | [10-20]  |
| Civica     | [ ]  |
| Capita     | [0-10]   |
| Omniledger | [ ]  |
| Others     | [ ]  |

Source: Tribal Group plc, provided by Capita.

60. This information suggests that the parties' share of legacy contracts is not particularly significant relative to other suppliers, and further that a greater number of operators are active in the sector than in relation to R&B. This conclusion is consistent with information received by the OFT during its investigation into the Northgate/Anite transaction. Indeed, evidence received in the context of that investigation indicated that Capita may have understated the shares of its competitors in Table 2 above.
61. For the reasons identified above in relation to R&B software services, the OFT does not consider legacy shares to be a good measure of the competitive environment. Capita argued that in SH software services, customers have a marked preference for competitive tendering because they are staffed by ex-employees of local authorities and are advised by consultancy firms.
62. Therefore, in forming its assessment on this market, the OFT has looked at UK share of supply data with respect to new (contestable) contracts. Whilst no evidence by Capita was presented on this issue, the OFT was in possession of information on new contracts by virtue of evidence provided by third parties. This data<sup>9</sup> indicated that the parties' share of new contracts (related to business since March 2006) was [35-45] per cent (Capita [5-15] per cent, IBS [25-30] per cent) and that there were three competitors with market shares of new business ranging between [10-20] to [15-25] per cent. Further to this, the bidding data indicated that six separate operators had successfully won since 2006, which is suggestive

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<sup>9</sup> Based on best estimates of the parties concerned.

of there being a larger number of active operators in the market relative to R&B.

63. No third parties identified substantive competition concerns arising from the merger. Although customers did not necessarily welcome consolidation, most third parties identified at least five other players in the market who could supply them with SH software services. This included suppliers over and above those identified within the parties' market share figures including Aareon, MIS Active, Simdel and Comino. Some customers and competitors commented that depending on the size of their organisation, the key players in the market would be IBS and Orchard (for housing associations) and Northgate (for local authorities).
64. Most customers said they had a degree of negotiating strength in this market, and no evidence was received to suggest that this would be diminished by the removal of one competitor in the market given the diversity of suppliers.
65. The data received by the OFT, combined with customer comments, indicates that although IBS is one of the main players in the market, Capita is a smaller player. The data illustrated that Capita has won less new contracts compared to some of its competitors, namely Aareon, Orchard and Northgate.
66. When comparing this market to the R&B software services market, the OFT notes the larger number of effective competitors and their relative strength (including Aareon, Orchard and Northgate). Compared to comments received in relation to Civica's R&B product, Civica appears to be an effective competitor in SH software services. Orchard was highlighted by customers as being a major player in the SH software services market. Finally, there exists a significant fringe of active players, whereas such a fringe does not exist in the R&B software services market.
67. On balance, the evidence is insufficiently strong to conclude that the competitive constraints on the merged entity will be substantially diminished. Specifically the OFT notes that the parties will face significant competitive constraints from a substantial number of alternative competitors and from other fringe competitors identified by customers. The OFT is satisfied that sufficient alternative players will remain in the market to ensure that any tendering process remains competitive (Northgate/Anite, Orchard, Aareon, SDM, Civica and Omniledger among others). No

customers identified substantive competition concerns arising from the merger. Accordingly the OFT concludes that no realistic prospect of a substantial lessening of competition arises as a result of the unilateral effects on the market for SH software services.

### **Coordinated effects**

68. For the reasons discussed above, the OFT considered carefully whether the merger is likely to increase the likelihood of coordination in the SH market.

69. Whilst noting that some of the factors that may increase the ability of parties to collude are readily applicable to the SH market, it is relevant that this market is characterised by a large number of operators (on the basis of legacy shares and of new tenders). Generally the likelihood of coordination falls significantly where there is a significant increase in the number of players in the market (five to nine players). Further, the same arguments as discussed in paragraph 55 apply equally to SH software services. No customers expressed concern about the possibility of coordination in the market. Given these factors and the lack of evidence of the potential for coordination, the OFT finds it reasonable to consider it unlikely that the merger will increase the likelihood of coordinated outcomes on this market.

### **ENTRY AND EXPANSION**

70. The OFT's '*Mergers - Substantive Assessment Guidance*'<sup>10</sup> (OFT Merger Guidelines) makes it clear that new entry must be sufficient in time, scope and likelihood to deter or defeat any attempt by the merging parties or their competitors to exploit the reduction in rivalry flowing from the merger.

### **R&B software services**

71. Capita initially submitted that there are no major barriers to new entry to the market for R&B software services. In its submission, Capita quoted the OFT decision in Northgate / Sx3 which indicated that there were no insurmountable barriers to entry or expansion.<sup>11</sup>

72. Capita considered that the most likely new entrants to the market are companies which already supply software, particularly financial software, to local government. Capita also stated that providers of software for use in social care have the necessary expertise to enter. Capita estimated the

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<sup>10</sup> OFT Merger Guidelines, paragraph 4.17.

<sup>11</sup> In that decision, the OFT did however note that timely entry may be difficult.

costs of entry for these players to be in the region of [ $< \text{£}2$  million] as they already have the necessary expertise. It argued that a new entrant could enter the market within a year to 18 months given the pool of available staff.

73. Subsequently, however, Capita submitted that there is unlikely to be any new entry in the short to medium term, but that a change in technology or legislation will prompt entry.
74. The OFT's investigations have cast significant doubt on the potential for new entry into the R&B segment. Specifically, the OFT has been made aware that the costs and time involved in entering the market with a new product are significant at around  $\text{£}2\text{-}10\text{m}$  and two years respectively. The costs of entry must be considered against the expected revenues from sales and the time period over which costs might be recovered, to assess whether firms wanting to enter the market will find entry profitable. The figures suggested that the payback period on investment would be substantial unless a new entrant was able to capture a large share of the market. One party indicated that on the basis of a very best case scenario, this period would be in the region of two years, although another identified a period of up to seven years.
75. With respect to the scope (or scale) of entry, the OFT notes that over the last three to four years the merging parties have accounted for a very significant proportion of newly tendered contracts for R&B software services. Therefore, it is arguable that entry would need to be on a large scale in order to restore competition lost as a result of the merger.
76. Comments received by the OFT support the assertion that the necessary costs and risk of being able to win new business given the existing players in the market, would discourage entry. Also, policy changes, which may occur as often as twice a year, were identified as a risk of entry and an ongoing sunk cost of supply.
77. Providers of software for use in social care acknowledged that entry was technically possible by extending existing software applications. They also suggested that they would have an adequate local authority footprint, reducing reputational concerns relevant to other new entrants. However, the OFT notes that this is at odds with comments made by the vast majority of local authorities. These authorities stated that they would not consider awarding a contract to a supplier with no track record in the

supply of R&B software services. During the course of its investigation, the OFT was able to identify only two firms that had considered entry in the past. However, neither had considered this as a viable option for the reasons discussed above. No companies identified an actual intention to enter and no instances of actual entry into the R&B market were provided by Capita, and the evidence collected suggests that the trend has been towards exit and consolidation rather than entry.<sup>12</sup>

78. In terms of **barriers to expansion**, Capita also stated that to the extent any barriers exist, these are low and that Northgate/Anite and Civica have the ability to expand immediately as they have access to a pool of suitable, knowledgeable staff and the software is capable of being licensed to any number of licensees. In generic terms, the OFT accepts that barriers to expansion for existing suppliers are low. However, the evidence discussed above casts significant doubt on the ability or incentives for Civica specifically to expand their operations to a significant degree. Specifically, the OFT noted numerous comments suggesting ongoing problems with the software of this company and a loss of confidence in the market generally, as well as evidence indicative of a lack of engagement in new business competitions. The OFT considers that Civica would have to invest significant sums in marketing and product development in order to successfully expand its operations and overcome technical difficulties as well as the perceptions of the market. The OFT is unaware of any significant reasons to suggest that the ability or incentive of Civica is likely to change significantly going forward.
79. Accordingly, the OFT does not consider that any entry or expansion in the supply of R&B software services would be timely, likely and of sufficient scope to mitigate unilateral effects concerns in this instance.

### **SH software services**

80. Capita considers that there are no major barriers to entry to the market for SH software services, nor are there any barriers to expansion.
81. However, given the absence of any concern arising on this market, the OFT does not consider it necessary to conclude on barriers to entry.

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<sup>12</sup> Recognised to some extent by Capita's internal documents.

## COUNTERVAILING BUYER POWER

82. Capita submitted that all R&B software services buyers exercise buyer power.<sup>13</sup>
83. In support of this argument, Capita submitted that local authorities are experienced and sophisticated buyers, have control over the tendering process, and have a choice of sufficient alternative suppliers. Capita also notes that wider relationships with local authorities, that is, the supply of other services to local authorities, means that Capita and IBS are incentivised to discount and enhance services.
84. As set out above, Capita also stated that there has been a dramatic reduction in the number of contracts put out to tender which they expect to continue over the short-to-medium term. Capita argued that this incentivises every market player to compete aggressively to increase their chances of winning new business, although for the reasons set out in paragraph 35 the OFT is not sufficiently persuaded by these arguments.
85. Capita submitted that the existence of buyer power was demonstrated by the fact that all R&B software services buyers are able to negotiate discounts on contracts. Figures provided by Capita indicate that there has been a high level of discounts from list price (that is, between first and second phase discussions in the tender process), particularly in recent years. They also contend that price discounts do not equate to a reduction in service quality, and provided an example of where price discounts accompanied an increase in service, for example extra add-ons. They state that it is a regular occurrence that discounts achieved by one customer have led to reductions in prices charged to others, due to user groups, and relationships between local authorities.
86. Capita noted that local authorities regularly discuss suppliers' prices with each other informally. [ ] Capita therefore contended that discounts achieved by one user may protect others.

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<sup>13</sup> As the OFT did not identify concerns in relation to SH software services, it did not investigate further buyer power in this market.

## **User Groups**

87. Capita submitted that user groups exert immense power over suppliers and empower local authorities to drive a hard bargain with suppliers by providing feedback on products and influencing the way products are delivered. Capita also stated that the user groups will negotiate purchases on behalf of their members in relation to upgrades and add-ons.
88. Capita also contended that user groups are key to referenceability of the suppliers' products and that any change in service quality to a particular customer would be passed on to other members of the user group. This would also have wider reputational effects (discussed below), which they contend would incentivise suppliers to remedy any problems quickly.

## **Negotiations on legacy contracts and add-ons**

89. Capita submitted that the reduction in the number of providers will not affect the ability of customers to negotiate on new contracts for add-ons to systems covered by existing contracts. They argued that the continued presence of Northgate as a strong competitor would ensure that customers have a valid and credible alternative at the point of contract negotiation and a point of reference to assess quality. Capita argued that when sophisticated buyers such as local authorities control the procurement process, the mere threat that a buyer could widen the list of solicited bids can prove sufficient to ensure competitive pricing.
90. Capita also submitted that add-ons are used as a negotiation tool by local authorities to get a reduction on software costs. It provided the OFT with an example of a situation where add-ons were used to attract a customer.

## **Reputational effect**

91. Capita argued that the size of the R&B software services market accounts for a small proportion of suppliers' overall revenue ([ ] per cent for Capita and [ ] per cent for IBS) and that both parties provide other software services to local authorities across a number of sectors.
92. Capita further argued that suppliers need to consider wider local authority markets, as local authorities can punish suppliers in other markets if they refuse to negotiate discounts for R&B software services, for example, by refusing to deal with them. By charging prices above competitive rates, by refusing to discount, or by reducing service standards Capita argued that a

supplier risks jeopardising their relationships with local authorities in other areas in which they generate greater revenue. Capita did not however present any [substantiated] evidence to the OFT as to the extent of such effects in practice.

## **Conclusion**

93. Whilst noting Capita's submissions on this issue, the OFT is not persuaded that post-merger buyer power will be sufficient to mitigate the concerns raised above. Specifically, the OFT considers that the loss of one of the two most effective competitors to Capita will constrain buyers' ability to widen the list of solicited bids to ensure competitive pricing. With an effective competitor to Capita removed from the market in the context of an already highly concentrated market, customers are likely to have considerably less choice of a credible alternative in terms of price and quality mix, making any threat to switch during negotiations of new contracts less viable, and thereby reducing their ability to exercise buyer power.
94. The threat of a local authority going out to tender again, or to re-negotiate if it is unhappy with its current supplier, is limited where there are only two players in the market. If a local authority does decide to go out to tender again, it effectively signals to the other market participant that they are not satisfied with the current supplier's product offering, as one of the main drivers of switching identified by Capita was dissatisfaction with the current supplier. In such circumstances this puts the other market participant in a strong ('residual' monopoly) position in terms of negotiation, reducing the negotiation strength of the local authority.
95. In addition, the OFT notes the concerns received from customers that the merger reduces their ability to negotiate discounts. They suggested that they would have reduced ability to negotiate with only two primary bidders in many cases and the prospect of a restricted supplier environment.
96. Subsequently, even if the OFT were to agree that the local authorities currently enjoy a degree of buyer power, it is not clear that this would be the case post-merger given the decrease in the number of effective R&B software services suppliers to just two suppliers (Northgate/Anite and Capita/IBS).

## **THIRD PARTY VIEWS**

97. The OFT received a significant amount of negative feedback from customers in the market and these concerns have been addressed in the text of the decision. In summary, third parties confirmed the fact that the market is highly concentrated and that there are a limited number of viable alternatives from which to source their products and services. Moreover, many customers indicated that a reduction of these effective competitors would materially affect their ability to negotiate on price. As a result of these factors the majority of those customers contacted indicated a high degree of concern regarding the merger. Customers also highlighted major switching barriers and a number were concerned that the merger would reduce the merged entity's willingness to customise the software to integrate with the local authorities' systems.
98. In addition to other actual and potential players in the market commenting on the improbability of entry and expansion (as discussed above), one third party noted that incentives to innovative and develop new software applications may be reduced as a result of the merger.
99. The OFT received a smaller number of comments in relation to SH software services. Although customers did not necessarily welcome consolidation, all customers were able to list a significant number of alternative suppliers. Most customers said they had a degree of negotiating strength in this market, and no evidence was received to suggest that this would be diminished by the removal of one competitor in the market given the diversity of suppliers.

## **ASSESSMENT**

100. The parties overlap in the provision R&B software services and the provision of SH services in the UK, which the OFT considers to be separate product markets, respectively.
101. In relation to R&B software services, the merger combines two closely competing successful bidders, with the parties often being each others' closest constraint. By absorbing IBS, Capita would face a significantly reduced constraint on its competitive behaviour such that it could profitably raise price or otherwise offer less favourable terms in relation, for example, to non-price factors (such as service quality or innovation which is unrelated to regular changes in the legislation) in relation to those contracts

for the supply of R&B software solutions that come up for renewal in the future.

102. The merger would mean that customers are left with only one effective alternative source of supply, Northgate/Anite, whose presence is not sufficient to replicate the competitive discipline posed by IBS absent the merger, when local authorities could benefit from rivalry between three successful bidders.
103. In relation to legacy contracts, the OFT does not consider that the threat of switching is significant or that there is a material competitive constraint placed on legacy suppliers by competition in the market for other contracts going out to tender. For these reasons, the merger does not create competition concerns in relation to legacy contracts to the extent that they are not put out to tender.
104. Customers expressed concern about the merger in that IBS, one of only two effective competitors to Capita has been removed from the market and this would materially affect their ability to negotiate better terms. Some expressed concern that they would face a restricted supplier environment and would likely experience a reduction in buyer power, implying less favourable terms of supply.
105. The degree of customer concerns, and the presence of only two effective competitors in the market, rule out the proposition that buyer power will resolve the above concerns. Equally, neither entry nor expansion in the supply of R&B software solutions would be sufficiently timely, likely and of sufficient scope to mitigate unilateral effects concerns.
106. The OFT believes that the characteristics of the market are such that any resulting competition concerns are more likely to arise with respect to primary unilateral effects, but has not ruled out the possibility of coordinated effects over time.
107. Therefore, the OFT believes, on the balance of probabilities, that it is case that the transaction has resulted, or may be expected to result, in a substantial lessening of competition, in relation to future contracts for the provision of R&B software services in the UK.
108. In relation to SH software services, the evidence is that the competitive constraints on Capita will not be substantially diminished by the merger. There are a significant number of alternative suppliers who will exercise a

competitive constraint on the parties and will ensure that tendering processes remains comparable competitive to the levels absent the merger.

109. Given the duty to refer in relation to R&B software services, exceptions to that duty become relevant. As set out in more detail below, Capita argued that the OFT should apply the *de minimis* exception in this case.<sup>14</sup>

### **Undertakings in lieu of reference and *de minimis***

110. As stated in the Dunfermline/BRN case,<sup>15</sup> and as explained further in the BOC/Ineos case,<sup>16</sup> the OFT believes that it would be proportionate to refer a problematic merger (that is, not to apply the *de minimis* exception) where it is clearly open to the party or parties to offer a clear-cut undertaking in lieu of reference – but they chose not to do so. This is because the recurring benefits of avoiding consumer harm by means of undertakings in lieu in a given, and all future like cases, outweighs the one-off costs of a reference.
111. As set out in more detail in the Dunfermline/BRN case, the OFT makes this judgment on an objective or 'in principle' basis at the stage of considering whether to invoke the *de minimis* exception, without regard to whether the parties have actually made such an offer, or the content of any such offer, neither of which will in any event be known to the decision maker at the time that application of the *de minimis* exception is considered.
112. In this case, it was not clear to the OFT, based on its objective evaluation of the transaction, that this case was a clear candidate for undertakings in lieu. This case does not fit the classic profile of the OFT's undertakings in lieu cases: in other words, a small proportion of a larger benign or even beneficial transaction raises concerns, and those concerns can be addressed structurally by means of a divestiture package. In this case, a structural remedy (that is, a divestment of IBS' R&B software services business) would raise concerns as to whether it was clearly and effectively separable from the remainder of IBS (eg by reason of shared software/codes). Such concerns might ultimately be surmountable, but the OFT will take a cautious view of the in principle availability of undertakings

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<sup>14</sup> See OFT 516 b, November 2007.

<sup>15</sup> *OFT Completed acquisition by Dunfermline Press Limited of the Berkshire Regional Newspapers business from Trinity Mirror plc* 4 February 2008.

<sup>16</sup> *OFT Anticipated acquisition By BOC Ltd of the Packaged Chlorine Business and Assets carried on by Ineos Chlor Ltd* 29 May 2008. See also *OFT Completed acquisition by Nufarm Limited of A H Marks Holdings Limited*.

in lieu when deciding whether the *de minimis* exception should be ruled out.

113. Therefore, the OFT accepts that it would not be appropriate, at this stage of the analysis, to rule out an evaluation of the *de minimis* exception in this case given that it would not appear to be open to the parties to offer a clear-cut – that is, effective and proportionate – undertaking in lieu.

#### **Application of the *de minimis* exception**

114. The pivotal issue for the OFT in applying its *de minimis* exception is determining whether the impact of the merger is likely to be particularly significant (such that the *de minimis* exception should not be applied) or more limited (when the OFT may apply the *de minimis* exception). The factors that the OFT considers in making this determination were set out in detail in the BOC/Ineos case and were applied again recently (in favour of exercise of the discretion) in FMC/ISP<sup>17</sup> and Orbital/Ocean Park<sup>18</sup> and (against the exercise of the discretion) in Nufarm/AH Marks.<sup>19</sup> Those factors are:

- market size
- strength of the OFT's concern
- magnitude of competition lost by the merger
- durability of the merger's impact, and
- transaction rationale and the value of deterrence.

#### **Application of the *de minimis* exception to the present case**

115. The OFT considered each of the factors above in determining whether to exercise its discretion in this case.

116. *Market size* – The OFT has found that there is a realistic prospect of a substantial lessening of competition in relation to future contracts for the supply of R&B software services in the UK.

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<sup>17</sup> *OFT Anticipated acquisition by FMC Corporation of the alginates business of ISP Holdings (U.K.) Ltd* 30 July 2008.

<sup>18</sup> *OFT Anticipated acquisition by Orbital Marketing Services Group Ltd of Ocean Park Ltd* 14 November 2008.

<sup>19</sup> *OFT Completed acquisition by Nufarm Limited of AH Marks Holdings Ltd* 29 August 2008.

117. In its original submission, Capita stated that the total annual size of the UK market for R&B software services was £[15-25] million. This figure reflected the estimated value of contracts for annual maintenance agreements and provision of contracted annual service agreements to existing local authority customers in the UK. The figure excluded revenues from new business sales, software/service sales to existing customers and income from work generated by legislative changes that was funded by DWP or by local authorities direct.
118. However, Capita argued that the OFT should apply the *de minimis* exception on the basis that the value of contracts expected to come up for renewal (where the OFT's concerns lay) was £[1-2] million for 2009 based on 2008 figures. This figure was based on an average of the value of contracts awarded in 2008 and taking into account software licence fees, implementation fees and maintenance fees.
119. The OFT is, however, not persuaded that the number of contracts coming up for renewal in 2008 alone is the correct way to ascertain the annual market size for the purposes of *de minimis*. As stated above, while the OFT accepts that the R&B software services market can be characterised at present by a relatively limited number of contracts expected to come up for renewal in the short term, this situation may change going forward. As a general statement, in lumpy markets, the OFT considers it artificial to consider the value of contracts for one particular year only as the appropriate figure, as this may grossly inflate or underestimate the true annual value of the overall market. In this case, although some customers will be subject to a fixed term contract, the OFT understands that a large number of contracts are rolled over, and as such are potentially available for retender. However, the OFT is not in possession of data to quantify this value. In addition whilst the OFT has little evidence of customers switching, or threatening to switch contracts other than Anite or Civica customers, the OFT cannot rule out that higher levels of tendering may occur going forward. For example, this may be triggered by technological developments or a major change in legislation, for example as a result of a change of government and subsequent amendments to the revenue and benefits structure.<sup>20</sup>

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<sup>20</sup> For example, Capita stated that it expects that: [ ]

120. Given this uncertainty,<sup>21</sup> and erring on the side of caution, the OFT considers that the figure of £[15-25] million provided by Capita should in fact be the starting figure for any *de minimis* arguments, whilst accepting that the actual value of future contracts may in practice be some way below this figure.
121. The OFT has, in previous decisions, considered the size of the market for *de minimis* purposes to be only the affected part of the relevant economic market.<sup>22</sup> However, in two of these three cases, even before excluding certain customer segments, the market size was below £10 million, and in all three cases it was very clear what portion of the market had the potential to be adversely affected by the lessening of competition. In the present case, the starting figure for the market size is significantly higher than £10 million and there is considerable uncertainty (reflecting the uncertainty about what contracts will be put out to tender in the foreseeable future) about the portion of the market that could be affected by the substantial lessening of competition. As such, the OFT does not view it as appropriate to consider reducing the market size to that suggested by Capita on this basis and considers instead that it is up to £[15-25] million.
122. On this basis, the true market size in this case may at the one extreme fall significantly above £10 million, and thus presumptively outside the potential field of application of the *de minimis* exception, equally, at the other, it could fall significantly under the £10 million threshold. For the sake of completeness, and to test the sensitivity of the OFT's analysis to an outcome that could favour the merging parties, the OFT considers the remaining *de minimis* criteria, assuming the affected market segment to be within the £10 million threshold, as follows:
- *Strength of the OFT's concerns* – The strength of the OFT's belief that the transaction may be expected to result in a substantial lessening of competition in relation to future contracts for the supply of R&B software services is relatively high, that is one of an 'on the balance of

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<sup>21</sup> On a simple calculation based on the number of Local Authorities (approximately 410) and an estimate of average product life cycle of 20 years (which would in fact be considered to be very long), the average number of contracts that would be expected to come up for tender in a particular year would be substantially greater than that estimated by Capita for 2008 (that is, 20 or more). This casts further doubt on the extent to which a figure of £[1-2]m is correct for the purposes of *de minimis* consideration.

<sup>22</sup> See *OFT Completed acquisition by National Express Group plc of the Intercity East Coast Rail Franchise* 20 December 2007 and *FMC/ISP and Orbital/Ocean Park*.

probabilities' standard rather than a 'realistic prospect' under the 'may be the case' standard. The relatively high strength of the OFT's overall belief that harm will result from the merger, although not in itself conclusive, points against exercise of the *de minimis* exception in this case.

- Magnitude of competition lost by the merger – The evidence received by the OFT indicates that the parties are often each others' closest constraint with limited actual or potential competing sources of supply. As a result, any price increases or decline in non-price factors resulting from the merger would be expected to be significant, pointing against the exercise of the *de minimis* discretion.
- Durability of the merger's impact – The evidence received by the OFT has not persuaded it that entry or expansion by alternative or existing suppliers will be sufficiently likely to counter a price increase or decline in non-price factors by the merging parties (that is: entry is not timely, likely and sufficient). Further, there is no evidence that the adverse effects would not in fact persist well beyond two years.
- Transaction rationale and the value of deterrence – Capita submitted that the acquisition was motivated by a desire to acquire IBS' SH software services business. The OFT notes that there is no suggestion on the evidence received by it that any acquisition of market power in relation to the supply of R&B software services specifically forms a material part of the commercial rationale behind the wider transaction – although it cannot discount the possibility that the transaction was motivated by the acquisition of market power at a wider level. On this basis, the OFT does not consider it appropriate to consider acquisition of market power as an important part of deal rationale, which would otherwise merit increasing the 'deterrence multiplier' in this decision for the purposes of its *de minimis* assessment.

123. Overall, the OFT considers that the combination of these various factors point towards the impact of the merger being significant. Given the uncertainty as to market size and the OFT's conclusion that it is likely that competition will be lost, the expected magnitude of that loss, and the OFT's inability to conclude that competitive constraints would be likely to emerge through entry even after two years, the OFT has decided not to exercise its discretion not to refer this transaction to the Competition Commission.

## Undertakings in lieu of reference

124. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted, or may result, from it.
125. In this case, Capita offered a series of potential undertakings in lieu. The undertakings offered by Capita in respect of R&B software services concerned the following:
- a. to maintain a choice of the IBS or Capita software systems for existing and new customers for [ ] years from the date of the undertakings
  - b. to continue to invest in both software systems for [ ] years from the date of the undertakings
  - c. [a pricing remedy], and
  - d. to waive any fixed term in Capita's favour in any existing contract.
126. The OFT welcomes the willingness of Capita to put forward remedies to seek to address competition concerns, but it does not consider that the remedies proposed in this case are capable of sufficiently removing the competition concerns arising from the merger in relation to the supply of R&B software services to the clear-cut standard required of undertakings in lieu.
127. As an initial point, the OFT notes that it is generally unlikely to consider that behavioural undertakings have sufficiently clear restorative effects to address the competition concerns identified in a merger.<sup>23</sup> In addition, undertakings in lieu of a reference are appropriate only where the remedies proposed to address them are clear cut.<sup>24</sup>

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<sup>23</sup> OFT Merger Guidelines, paragraph 8.10.

<sup>24</sup> OFT Merger Guidelines, paragraph 8.3.

128. The OFT has concerns that the remedies, which do not purport to restore competition between independent suppliers, fall short of these standards. Firstly, the pricing remedy as set out in 'c' above is likely to be complex and difficult and costly to monitor. [ ]. Further, the remedy proposed under 'a' would not mitigate the competition effects discussed above. Specifically, as noted above in the competitive effects section, during competitive tendering it is the case that pre-merger customers would have a choice of two independently operating suppliers, whereas post merger, customers would have the choice of only one supplier, albeit with two separate product offerings.
129. For the reasons discussed above, the OFT does not believe that the remedies proposed by Capita meet the clear-cut standard for undertakings in lieu and, therefore, the duty to refer remains.

## **DECISION**

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