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Anticipated acquisition by Sportech plc of the Vernons football pools business from Ladbrokes plc

The OFT's decision on reference under section 33(1) given on 3 May 2007. Full text of decision published 15 May 2007.

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

## PARTIES

1. **Sportech plc (Sportech)** is active in the betting and gaming sectors. Sportech, through its subsidiary Littlewoods Promotions Limited, operates the **Littlewoods football pools (Littlewoods)** and the **Zettors football pools (Zettors)**.
2. **Ladbrokes plc (Ladbrokes)** is active in the betting and gaming sector.<sup>1</sup> Ladbrokes, through its subsidiary Vernons Pools Limited, operates the **Vernons football pools business (Vernons)**. The UK turnover of Vernons in 2005 was approximately £18 million.

## TRANSACTION

3. Sportech proposes to acquire from Vernons Pools Limited the assets constituting its football pools business together with the entire issued capital of Vernons Games Ltd, Vernons Trustee Company Ltd and Vernons Financial Services Ltd. In addition, Ladbrokes and Sportech will enter into arrangements for the distribution of football pools products through Ladbrokes' licensed betting offices.

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<sup>1</sup> Ladbrokes later clarified that it is no longer active in the hotel sector.

4. One of the motivations for the deal is [ ]. Sportech also argues that the acquisition of Vernons will allow it to create economies of scale, reduce costs and increase the size of the prize pool, which it says will benefit customers and attract new ones.
5. The Office of Fair Trading's (OFT) administrative deadline for deciding whether to refer the merger to the Competition Commission is 10 May 2007.

## **JURISDICTION**

6. As a result of this transaction Sportech and Vernons will cease to be distinct. The parties' combined share of supply of football pools in the UK is almost 100 per cent (by volume and value) and as a consequence the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. 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.

## **FRAME OF REFERENCE**

7. The parties overlap in the supply of fixed-odds lottery games and football pools. However, the combined share of supply of fixed-odds lottery games is minimal and therefore this overlap is not considered further.
8. Football pools is a game in which participants score points by correctly predicting the results of a number of football matches in order to win some money from the prize pool. Football pools operators prepare a weekly coupon listing 49 football matches (across several divisions) to be played on a Saturday. Each football pool operator lists the same 49 matches. Each football match is allocated a number from one to 49, typically in alphabetical order on a league by league basis. Participants then attempt to select eight score draws and win a share of the prize pool.
9. The game awards three points for a score draw, two points for a no-score draw or void match, and one point for a home or away win. Participants are able to make 10, 11 or 12 selections, with the best eight selections used to tally the total points. The first prize is shared amongst participants who have scored 24 points. However, each coupon contains a number of

competitions or pools. For example, besides the overall outcome of the match, participants can also play a pooled game predicting the half-time result or the number of overall goals in the game.

10. UK consumers spent almost £80 million on playing the football pools last year.

## **Product scope**

11. The parties argue that football pools is part of the same product market as the National Lottery. If the OFT was not persuaded that this was the relevant market, the parties submitted in the alternative that Vernons and Littlewoods each operate in their own separate product markets.

## **Customers switching to the National Lottery**

12. The parties provided evidence of the impact that the launch of the National Lottery in 1994 had on the number of people playing the football pools and the subsequent football pools revenues. The number of football pools players fell from around ten million before the National Lottery started in 1994 to around 830,000 in 2006, despite this being a period in which gambling flourished. Similarly, football pools revenues dropped sharply (25-30 per cent per year) in the years following the launch of the National Lottery, and have continued to fall at a rate of 5-15 per cent per year in recent years.
13. The OFT considers that the evidence presented to it that the introduction of the National Lottery (some 13 years ago) triggered the switching of a significant number of customers in the years following its launch to be persuasive. However, the OFT considers that the evidence shows that the National Lottery does not continue to act as a significant competitive constraint in relation to the remaining football pool customers, who are likely to be more price inelastic than those who switched some years ago. In essence, before 1994, people who wanted to play a pools-based game did not have the option of the National Lottery and so a large number of them may have played the football pools as an imperfect substitute. Once the National Lottery was launched, football pool players could then exercise their option to continue with the football pools or to switch to the National Lottery. Likewise, new customers can now select either the football pools

or the National Lottery (or indeed other soft gambling products). Therefore, the OFT does not consider that those who have chosen to remain with the football pools (or new players choosing the football pools) would be inclined to switch to the National Lottery in significant numbers in response to a small but significant (5–10 per cent) price rise. Interestingly, however, no football pools operator decreased its minimum stake when the National Lottery entered in 1994<sup>2</sup> although Vernons did increase its payout ratio over this period (Littlewoods did not).<sup>3</sup>

14. The parties provided a survey commissioned by Sportech in late 2006 in which 250 lapsed players<sup>4</sup> were interviewed. Of the 87 respondents who had switched to, or increased their expenditure on an alternative gambling product, 71 had chosen the National Lottery (82 per cent of the lapsed players who switched to another gambling product). Overall, this survey indicated that 28 per cent of all Littlewoods' lapsed players now play the National Lottery, but the majority of lapsed players (65 per cent) did not switch to any other gambling product.
15. The proportion of Littlewoods' lapsed customers increasing their expenditure on, or switching to, the National Lottery is not entirely surprising given that, according to the parties, around 70 per cent of adults in the UK play the National Lottery on a regular basis. The choice made by lapsed football pools players is, thus, consistent with the choices made by the wider population. When the same survey asked lapsed players why they were no longer playing the football pools, only 3 per cent said that they preferred the National Lottery. Of those who did not play the pools at all, only 12 per cent gave the reason of preferring the National Lottery over the football pools.
16. Internal documents submitted by the parties present a mixed message regarding the National Lottery. Being a stronger competitor to the National Lottery is not mentioned in the business case for the deal [ ]. However, in Littlewoods' 'strengths, weaknesses, opportunities and threats' (SWOT) analysis, the National Lottery is mentioned as a threat to the business.

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<sup>2</sup> Littlewoods increased its minimum stake from 60p to 75p in 1999.

<sup>3</sup> The payout ratio is the proportion of the money spent by customers on the football pools that goes into the pool of prize money.

<sup>4</sup> Littlewoods customers who had ceased playing Littlewoods pools in the 24 months prior to the survey.

17. The parties commissioned an econometric study to support their view that the National Lottery and the football pools are in the same relevant market. This study focused on the effect of a rollover in the National Lottery, which occurs when the jackpot is not won and is added to subsequent contests, increasing the size of the jackpot to be won. The econometric study concluded that a rollover – which effectively decreases the relative price of the Lottery against the football pools – would result in a decrease in the number of players playing Littlewoods football pools.
18. The study shows a correlation between a rollover and the number of players playing football pools with Littlewoods.<sup>5</sup> Because the study was limited in nature (taking into account only Littlewoods' customers) and aspects of the choice of specification underlying the study were insufficiently supported, the OFT does not consider the National Lottery to be in the same product frame of reference on the basis of this study alone. Furthermore, even if the study were correct in portraying the switching behaviour of those customers, taking into account the whole range of evidence available before it (including compelling evidence that the National Lottery is not in the same frame of reference), the OFT does not consider that the two products are in the same frame of reference.

## Characteristics of the game

19. The parties argue that the characteristics of football pools and the National Lottery have become closer over time, with 85-90 per cent of Littlewoods' customers choosing the same numbers each week. The parties infer from this that most customers do not apply skill to try to guess the football results, and as a consequence the football pools are seen by them as a game of luck, like the National Lottery. In addition, prior to the launch of the National Lottery the number of games listed on the football pools coupon exceeded 49, but this was reduced and is now in line with the National Lottery.
20. The evidence before the OFT indicates that regardless of the degree of skill or luck involved, the link to football is an important driver of the demand for football pools. In a survey commissioned by Sportech in 2006, the

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<sup>5</sup> Note however that the study took account only of Littlewoods players (because this data was readily available), and does not therefore consider whether customers of the other pools providers, whose prices are relatively cheaper, are as likely to switch to the National Lottery when a rollover occurs.

importance of the link with football was rated 'very important' or 'fairly important' by 77 per cent of interviewees.<sup>6</sup> Other internal documents also indicate that the link to football is important (for example, expecting the World Cup to stimulate demand). This is consistent with the comments made by a number of customers who said that they value the pools because of its link with football. Interestingly, even customers who choose the same numbers every week cited the link with football as a reason for playing the pools, and that the enjoyment of this link might be not only at the time of playing the pools, but also at the time of checking the results, which some claimed makes following the football results more interesting. Finally, the parties told the OFT that it is part of their marketing plans to emphasise the pools' link with football.

### Football pool operators as their own product scope

21. The parties submit that there is limited customer switching and competitive interaction between Littlewoods and Vernons and that the two companies have a different set of customers and distribution channels.
22. Third parties' comments (below) suggest that they believe that the football pools' closest competitors are other football pools operators, and that football pools operators constrain each other's prices and offerings.
23. Littlewoods' internal document setting out the business case for the merger says that the deal will [ ]. Samples of Vernons' marketing campaigns focus on pointing out the attractiveness of its own football pools in relation to Littlewoods', although limited reference to the National Lottery is also made (the odds of winning the pools is seven times higher than the odds of winning the Lottery). It has also been put to the OFT by third parties that the parties buy mailing lists likely to contain customers of the other football pools and target them specifically. The parties said that these marketing tactics have failed, but provided no supporting evidence.

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<sup>6</sup> Interviewees included pools players (40 per cent), lapsed pool players (20 per cent) and non-pool players (40 per cent), but the importance of the link with football ranked highest among current and lapsed players.

## Third party comments

24. A very large number of customers contacted the OFT raising concerns that the merger would leave them without a choice, implying that they did not consider the National Lottery to be a reasonable substitute for the football pools. Other third parties contend that the National Lottery is not a significant competitive constraint on football pools. In fact, some third parties have told us that they believe that the price of football pools is not affected by the National Lottery, and that there is no evidence that customers dissatisfied with the football pools would switch to play the National Lottery.
25. The OFT surveyed a number of customers of Littlewoods, Vernons and Zettors, which included a larger number of (mostly Vernons') customers who had contacted the OFT concerned about the merger. Prompted about what they would do in case their provider of football pools increased prices by 5-10 per cent, from a total of 61 customers interviewed, only 8 per cent would switch to the National Lottery. In fact, 44 per cent of customers would stay with the same football pools provider, 34 per cent would switch to a different football pools provider and 13 per cent would stop playing the football pools.<sup>7</sup>

## Conclusion

26. On the basis of the evidence available to it, the OFT considers that it is likely that the National Lottery imposes a limited competitive constraint on football pools providers. Switching clearly took place at the time of entry of the National Lottery and it may still provide a limited competitive constraint today. However, the OFT does not consider that the National Lottery is a significant competitive constraint on football pools' pricing and behaviour today. Nor is the OFT satisfied that the evidence before it leads to the conclusion that Vernons and Littlewoods each form separate product scopes. Therefore, a cautious approach is taken and the frame of reference

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<sup>7</sup> The figures are not significantly different if only the customers who had not complained to the OFT were considered (in other words, customers who were randomly selected by the parties from their customer base and to whom the OFT sent questionnaires): of the 36 remaining respondents, 58 per cent would stay with the same football pools provider, 17 per cent would switch to a different football pools provider and 19 per cent would stop playing the football pools, and only 6 per cent would switch to the National Lottery.

is considered to be football pools, not including games such as the National Lottery.

## **Geographic scope**

27. The parties submit that the geographic scope of the frame of reference is the UK. The OFT does not have any evidence to diverge from this definition. Prices for the football pools do not vary between regions or locality, transport costs are not an issue, the football games on each operator's coupon are the same everywhere as are the other product characteristics.

## **HORIZONTAL ISSUES**

28. The parties' combined share of supply of football pools in the UK is almost 100 per cent (increment of around 24 per cent by value).
29. There is limited evidence on current switching activity from one football pools to the other. However, given that Littlewoods has not changed its minimum stakes since 1999, and Vernons has not changed its minimum stakes since the launch of the National Lottery, it is perhaps not very surprising that switching has been low. The evidence that was presented to the OFT – based on a survey of football pools players – showed that switching from Littlewoods to Vernons has been very low (less than ten per cent of lapsed players who switched to another gambling product). It could be the case that switching is more likely to take place from Vernons to Littlewoods since Littlewoods has a significantly higher prize pool, but the OFT does not have any evidence that this is the case.
30. Nevertheless, a number of customers told the OFT that they used to play Littlewoods and switched to Vernons when Littlewoods' minimum stake increased because Vernons offered 'cheaper prices' and/or 'better value for money'. This is consistent with the fact that Vernons' share of supply has been increasing steadily since 1999, when Littlewoods' minimum stake went up (Vernons' share of supply increase is particularly marked when it is calculated by number of customers since its minimum stake is around half of Littlewoods).

31. As a further example of how the parties compete against each other, the OFT was told that, following Vernons' aggressive campaigning from 1999-2000, Littlewoods reacted by increasing free bet offers, and increasing the top prize to £1m, which was then matched by Vernons and later increased to £2m by both companies. The parties said that these prizes were set as a response to the National Lottery offering large jackpots, but did not provide evidence to support this assertion.
32. Despite the overall decline in the number of people playing the football pools, there may be competition between football pools operators in attracting new players. One way in which they seem to do this is by differentiating their product offers. For example, a number of third parties commented that the choice is between 'paying more to win more but have fewer chances of winning' (with Littlewoods) or 'paying less to win less but have more chances of winning' (with Vernons).
33. Football pools coupons are sold either directly (in retail shops, the Tote, post, phone or the internet) or through door-to-door collectors. Approximately half of Littlewoods' and Zettors' sales are made through collectors, although this share has been declining year by year. Vernons closed its collector network in 1998, which caused its sales to decline significantly (although it lost less than two per cent share of supply, this picked up again in two to three years).
34. The parties submit that the fact that Vernons' decision to abandon its collector network did not cause a positive effect on Littlewoods' sales demonstrates that the distribution channels of Vernons and Littlewoods are not good substitutes. This is not surprising, given that an economic report commissioned by Sportech notes that 'there was only limited geographic overlap between Littlewoods and Vernons' (in relation to their individual collectors' 'territories').

## **Counterfactual**

35. The parties submit that, should the merger not go ahead, Ladbrokes will continue to operate the Vernons football pools but [ ].

## Barriers to entry

36. There is limited evidence available to the OFT that entry into the football pools market would be sufficient in time, scope, and likelihood to deter the merged entity from exploiting the lessening in rivalry arising from the merger. The main barrier to entry seems to be the branding and reputation of a football pools provider. There is no history of recent successful entry, and there do not seem to be any credible potential entrants in the near future, especially on a scale similar to Vernons that could offset the loss of competition resulting from the merger. In fact, third party comments suggest that it is very unlikely that a new football pools provider will be launched in the near future.
37. What is more, demand for football pools has been declining dramatically since 1994 which has reduced the attractiveness of entering, especially in light of the need to generate a critical mass of customers to finance a significant and attractive weekly prize pot.

## Customer benefits

38. The OFT can exercise its discretion not to refer a merger on the basis of customer benefits. In order to do this, the parties should be able to produce detailed and verifiable evidence of any price reductions or other benefits resulting from the merger.<sup>8</sup> The parties must also show that the merged entity will have the incentive to pass benefits on to customers and that these benefits will be sufficient to outweigh the competition detriments caused by the merger.<sup>9</sup>
39. The parties submit that the merger will allow customers to benefit from an increased prize pool, greater choice of distribution channels and increased value and attractiveness of the product.
40. However, the OFT considers that the parties' claims that the merger will generate customer benefits that will be passed on to customers are not adequately supported. In particular, it is not clear that the merged entity will have the incentive to pass on cost reductions to consumers and to increase the size of the prize fund, nor that customer benefits would be

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<sup>8</sup> 'Mergers: substantive assessment guidance', OFT516, May 2003, paragraph 7.7.

<sup>9</sup> OFT516, paragraph 7.8.

large enough to offset the potential harm. Furthermore, it appears to the OFT that many of the customers benefits cited by the parties are not dependent on the merger (for example, modifying the games to make them more attractive to younger players).

### **THIRD PARTY VIEWS**

41. The OFT was contacted by 116 Vernons customers concerned about the merger. The OFT also heard from a few employees and other people involved in football pools and in the gambling business more widely. In addition, 61 customers completed the OFT survey sent to customers of Littlewoods, Zettors and Vernons, of which 25 had chosen to make contact with the OFT. The concerns and perceptions of the market expressed to the OFT have been dealt with above.

### **UNDERTAKINGS IN LIEU**

42. Where the duty to make a reference under section 33(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from the parties concerned such undertakings as it considers appropriate.
43. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's Mergers Substantive Assessment Guidance states that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation' (para 8.3).
44. Sportech offered the following undertakings: [ ].
45. The OFT considers that the behavioural undertakings offered manifestly fail to meet the criteria set out in the OFT's Mergers Substantive Assessment Guidance. They are not clear cut or capable of remedying the adverse

competition effects that this merger will give rise to, and therefore the duty to refer remains. [ ].

## **ASSESSMENT**

46. As a result of the proposed merger Sportech will supply virtually 100 per cent of UK demand for football pools. Although the National Lottery provides a limited competitive constraint on football pools providers, on the evidence available the OFT does not consider that this constraint is sufficient to prevent a monopoly provider of football pools from reducing consumer welfare. The OFT considers that current customers are less sensitive to price increases than those who switched away, and therefore more likely to continue playing the football pools even if prices go up, the pay-out ratio is lowered and/or the quality of services is decreased.
47. Although competition between Sportech's brands and Vernons may not be vigorous, the evidence before the OFT indicates that they do compete against each other, in particular by using marketing campaigns to attract new and lapsed players and by using their product differentiation to illustrate differences in their value-for-money, suggesting there would be adverse effects arising from the merger's elimination of rivalry between the parties.
48. Finally, the available evidence on entry and expansion does not resolve the concerns raised by this degree of concentration, and countervailing buyer power is not a relevant issue in this case.
49. Consequently, the OFT believes 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**

50. This merger will therefore be referred to the Competition Commission under section 33(1) of the Act.