Anticipated acquisition by Halliburton Manufacturing and Services Limited of PSL Energy Services Limited

The OFT's decision on reference under section 33(1) given on 3 July 2007. Full text of decision published 12 July 2007.

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

PARTIES

1. **Halliburton Manufacturing and Services Limited** ('HMSL') is a UK subsidiary of **Halliburton Company** (Halliburton), a diversified energy services company. Halliburton's turnover from its UK operations in 2005 was US$2,013 million (around £1,003 million). Halliburton is headquartered in Houston, USA but operates globally with over 200 subsidiary companies.

2. **PSL Energy Services Limited** ('PSL') is a company specialising in the provision of process, pipeline and well services to the oil and gas industries. PSL is headquartered in Aberdeen but operates globally with numerous subsidiaries. PSL's UK turnover for the year ended 31 December 2006 was $84.3 million (around £42.6 million).

TRANSACTION

3. On 26 April HMSL agreed to acquire all the issued share capital of PSL for the consideration of US$256 million (around £128 million). The transaction is conditional on clearances from the UK, Norwegian and Azerbaijani competition authorities. The OFT's administrative target for a decision is 3 July 2007.

JURISDICTION

4. As a result of this transaction HMSL and PSL will cease to be distinct. The transaction satisfies the share of supply test under section 23 (2) (b) of the Enterprise Act (the Act) as the parties' combined share of supply in the UK for well intervention services exceeds the 25 per cent threshold.

5. 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

6. Both HMSL and PSL provide services to install, maintain and repair oil and gas pipes, wells and drilling infrastructure. The parties suggest that their activities can be separated into three broad categories according to the specific nature of the services required: process services, pipeline services and well intervention services. Each of these types of service encompasses several components which, although technically distinct, exhibit a high degree of complementarily to the extent that they are part of a chain flow and as such, they may be purchased on a single contract basis.

Process (i.e. non-pipeline) services

7. These include any and all services associated with non-pipeline equipment, such as filling, flushing, cleaning, internal inspection, bolt torque/tensioning, pressure testing, leak testing, drying, purging, and chemical conditioning.

Pipeline services

8. These relate to services provided on newly constructed or existing pipelines. They include services involving filling, cleaning, gauging, internal inspection, isolating, pressure testing, dewatering drying or chemically conditioning a pipeline.

Well intervention services

9. These are services provided in order to optimise the productivity of a well while it is in operation.

Product market

Demand-side substitutes

10. The OFT considers that most responses from third parties on the degree of demand-side substitutability support a separation between each of these three types of service, as each is a specialist service not easily substitutable for carrying out a specific task.

11. However, some third parties also suggested that pipeline and process services may be sufficiently similar for customer contracts to cover both of these types of service, which may aid supply-side substitution between process and pipeline services. Customer details provided by the parties also show a difference in the type of customer for well intervention services, with more similar customers for pipeline and process services.

12. The nature of the services means that customers normally set the scope of the contract (in terms of the type or types of service to be provided) and then invite bids from suppliers. Evidence before the OFT shows that although some customers seek the services as an integrated package from one supplier, there are relatively few suppliers bidding for integrated solutions, and a second 'tier' of smaller but more specialised suppliers provide one of the required services via sub-contracting. Conversely, some customers prefer separate tenders for each service, often based on strategic or security of supply considerations.

Supply-side substitutes

13. A broader definition is supported by the presence of a number of suppliers that cover all three types of service (HMSL, PSL, BJ Services, Q-Serv, Baker Hughes) but there are also a few suppliers that only offer well intervention services (Schlumberger, Expro), which would suggest that well intervention services may be considered to be separate in terms of the equipment and skill sets that are required to perform these particular

functions. The parties' internal documents also refer to pipeline and process services together, separately from well intervention services.

14. Some third party responses indicate that switching between providing the three different types of service is both costly and time-consuming, for example, due to the lead times associated with equipment orders and availability of suitable personnel. However, one of the current 'full-service' suppliers (Q-Serv) only commenced doing so relatively recently (November 2001), which suggests that whilst some barriers to switching may exist, suppliers of other services can enter, though this is explored further in the section on barriers to entry.

Conclusion

15. There is mixed evidence on the extent to which the three types of service should be considered separately or together. Adopting a cautious approach therefore, this analysis uses the narrowest possible product frame of reference – that is, consider each of the three services separately. However, given the outcome of the competitive assessment and the few concerns that were expressed by third parties, a definitive conclusion on the precise product frame of reference is not required in this case.

Geographic market

16. The parties submit that the geographic frame of reference is global for all three services (pipeline, process and well intervention services), due to the ability of the parties and other suppliers to offer such services all over the world; third party responses confirm this. In addition, the parties submit that there are limited regulatory or licensing restrictions that would constrain the global movement of both equipment and staff.

17. The OFT has not received any convincing evidence that would lead to a narrower geographic scope, meaning that the relevant geographic frame of reference is likely to be global for all three services.

HORIZONTAL ISSUES

Market shares

18. The marketplace in which the parties operate is characterised by the award of contracts through tender processes. The parties submit that many thousands of contracts are awarded globally annually, but only a small number of 'major' projects are awarded. As work generally relates to one-off operations, which offer no guaranteed opportunity for repeat business, these 'major' contracts are highly sought after since they offer the opportunity for longer term, more significant, revenue streams.

19. Information from both the parties and third parties indicates that bidding for contracts can include suppliers jointly bidding for business - these can be either informal alliances or two-tier contracts, where the second-tier element is usually a small part of the contract (in terms of value) which on its own would not justify a separate contract, though the use of such contracts depends on the particular service supplied.

20. Internal documents from the parties identified six main competitors for services in the UK North Sea and third parties also suggested that there were only four 'full-service' suppliers, with approximately a further fifty capable of offering pipeline or process services individually. Bidding data indicates however that these smaller suppliers are successful in winning contracts for pipeline and process services, though less so for well intervention services.

21. In considering the potential for unilateral price increases the merger has been analysed both in terms of shares on a revenue basis and on a contracts basis. These shares are given on a global basis as well as in relation to the services provided in UK territorial waters, including the UK sector of the North Sea.

Process services

22. The parties have a post-merger share of supply of [5 - 10] per cent (global) and [15 - 20] per cent (UK). This leads to the creation of the leading supplier of process services in the UK and the second-largest supplier on a global basis, though the increment in both cases is only [0 - 5] per cent. The market for process services in the UK is however

growing – an average annual growth rate of 16.6 per cent for 2004-6 and there are other significant suppliers of process services in the UK (Hydratight, RBG and BJ Services) and there are also several suppliers not currently active in the UK (Praxair, Hydrochem, Philip Services) but with a significant global presence.

23. The parties' share in terms of UK contracts in process services is also not particularly high (only [15-20] per cent in 2006) and for these services the parties suggest that the value of a 'major' contract would be in excess of $250,000, of which there will be around 15-20 such contracts of this size available in the UK every year.

24. UK bidding data provided by the parties for the last three years shows that HMSL has only bid for a single 'major' contract in this time (which it won), whilst PSL has bid for [ ] 'major' contracts, of which it has been successful [ ] times and HMSL has not bid in any of these. The OFT considers that this data shows that, in the UK at least, the parties do not closely compete with one another in the supply of process services and other suppliers provide effective alternatives for customers.

Pipeline services

25. The parties have slightly higher shares of supply for pipeline services, a combined post-merger share of supply of [10-15] per cent (global) and [20-25] per cent (UK). This leads to the creation of the leading supplier of pipeline services in the UK, with an increment of [10-15] per cent as a result of the transaction, and the third-largest supplier on a global basis, with an increment of [0-5] per cent. Total revenues for pipeline services in the UK have also increased quite quickly in recent years (19.5 per cent average growth in 2004-2006) and PSL has again increased its revenues and share of supply significantly. There are however other large suppliers both globally (General Electric, Rosen, Weatherford) and in the UK (General Electric, BJ Services, Norson). Two of these competitors have also doubled their share, suggesting the emergence of effective competitors in pipeline services.

26. The parties hold a slightly higher share of supply in terms of UK contracts (25-30 per cent), suggesting that their activities are concentrated in low-value contracts. Bidding data for 'major' (over $250,000) UK contracts over the last three years shows that HMSL have bid for [ ] contracts, of

which they have won [ ]; PSL have bid for [ ] contracts, of which they have won [ ], with one competitor successful in 20, posing competitive constraint.

27. This bidding data also shows that the parties have bid against one another three times over the last three years for 'major' UK contracts, which indicates that the parties exert only a limited constraint on one another in the supply of pipeline services.

Well intervention services

28. In the case of well intervention services, the combined post-merger share of supply will be [25-30] per cent on both a global and UK basis. The increment to the parties' combined share is less than [0-5] per cent globally and almost [5-10] per cent in the UK. The merger will lead to the creation of the largest global provider of well intervention services and the second-largest UK supplier.

29. Competitors' shares have stayed broadly stable over the past three years, with just one competitor losing share to another, though this served to increase the number of significant suppliers for well intervention services. The total UK revenues for well intervention services have not increased by as much as for process or pipeline services – 8.7 per cent average growth in 2004-6. This growth could be a reflection of the fewer 'major' contracts available for these services annually. On data available to the OFT, the parties have not increased their number of contracts held in the last two years. Bidding data for 'major' (in excess of $500,000) contracts over the last three years shows that HMSL has won [ ] of the [ ] contracts it bid for, which is the same number as some competitors; PSL have been successful [ ] times for [ ] contracts it has bid for, with a competitor successful eight times and another competitor five times. In the OFT's view, this data shows that other suppliers of well intervention services provide a viable alternative to the parties for well intervention service customers. This bidding data also shows that the parties have bid against one another only three times over the last three years for 'major' contracts in well intervention services, which suggests that the merger would not lead to the loss of a significant competitive constraint on either party.

30. At least two competitors have developed a significant presence in well intervention services and the parties' combined share on a contract basis is slightly lower than on a revenue basis. Bidding data also indicates that other suppliers have been effective at winning contracts in this area and indicates that the merger will not represent the removal of a significant competitive constraint on either of the parties. Significantly, no competitors (large or small) raised concerns regarding the merger.

31. Overall, the OFT considers there is no realistic prospect of that the merger will give rise to unilateral effects in any of the three services.

Coordinated effects

32. On the basis of the information available to the OFT on the way in which work is awarded, primarily through tender processes, the nature of supplier relationships in jointly bidding for contracts may raise potential concerns over the possibility of coordinated effects.

33. However the parties argue that the necessary investment in equipment and personnel for providing all three types of service represents a fixed cost, which reduces the incentive for collusion amongst suppliers, as each would look to maximise the utilisation of their assets by pricing to win contracts.

34. The parties also argue that the relative paucity of 'major' contracts also reduces the incentive for co-ordination between suppliers, as the gains derived from cutting tender prices on a particular contract are considered to outweigh the foregone profits resulting from a potential price war on future contracts.

35. There are relatively few 'full-service' suppliers that can offer all three types of service and third parties indicated that contracts did not usually comprise a bundled set of services as most customers choose to split their contracts; this all reduces the possibility for co-ordination among these 'full-service' suppliers over the three types of service considered here.

36. No previous OFT cases in relation to products and services supplied in this sector have considered co-ordinated effects to be an issue and there has been no evidence in this case to suggest anything to the contrary.

Barriers to entry

37. The parties argue that the conditions under which the services affected by this merger are supplied display a number of features that indicate low barriers to entry and expansion. These include: the availability of short duration contracts across a number of territories; intellectual property rights and patents not being prevalent; the ability to sub contract in whole or in part; the lack of major regulatory hurdles (in terms of licensing and planning) to provide services in international waters (for the global transfer of both equipment and staff); equipment being generally available second-hand or to rent (to reduce sunk costs); staff being available for hire; and finally, the unimportance of brand loyalty.

38. Although third parties agree that availability of contracts is a key factor, they point out that each service requires a slightly different type and level of equipment and equipment inventory. Some estimated a budget of £5m-20m would be required for a reasonable level of capacity, with an estimated break-even point of three - five years. Apart from cost, third parties also suggest that high asset utilisation levels, low availability of equipment and long lead times for orders – between 12-24 months on certain equipment types – may also constrain both entry of new suppliers and expansion of existing providers. The most recent new full-service entrant (Q-Serv, which entered in November 2001) took until January 2003 to receive all the necessary certification and accreditation, which – given the importance of health and safety pre-qualification in bidding for most contracts – suggests that this might be an additional barrier to entry for entirely new suppliers.

39. The parties' internal documents do confirm this is an issue in the industry commenting that HMSL's expansion without the merger, with a lack of personnel and lengthy lead times of equipment, meaning that it would not be able to expand as quickly organically as through acquisition. However, such delays are typically less than two years, which may facilitate timely entry and/or expansion.

40. The parties also provided evidence of entry in the supply of all relevant services in the last five years (pipeline services – Weatherford, GE; process services – Weatherford, B&W Fluid Dynamics; well intervention services – Q-Serv, Balance Point) over the past five years to provide a credible competitive constraint (though bidding data for major contracts

indicates that smaller suppliers tend to operate more as sub-contractors rather than bidding as primary contractors). Finally, the presence of smaller suppliers that are active in only a relatively narrow geographical area indicate that the investment required to compete effectively, albeit in a limited sector of a market, need not involve investing in assets and staff on a global basis.

Buyer power

41. No third party responses indicated that the merger would reduce their negotiating strength, or leave them without a number of suitable alternative providers.

VERTICAL ISSUES

42. There were no vertical links between the parties prior to the merger and none of the suppliers contacted about the merger expressed any concerns.[1]

THIRD PARTY COMMENTS

43. There were very few concerns raised by third parties, with most third party comments addressed above. Two customer concerns raised were both qualified – one felt that the merged entity would look to increase prices following the merger, but also thought that there would be a number of alternative suppliers; the other expressed concern as to whether HMSL would continue to provide a full range of services currently offered by PSL, but also felt that there was strong competition amongst suppliers.

ASSESSMENT

44. The parties overlap in the supply of a range of services to support the development of oil wells, which the parties have suggested be grouped into three categories: pipeline services, process services and well intervention services.

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[1] Halliburton is a member of the Surestream Alliance and through this body it has a relationship with Pipeline Engineering for certain flow assurance pipeline work.

45. Adopting a cautious approach our analysis is premised on the narrowest basis by considering each of the three services separately, but the lack of third party concern and impact on the outcome of the competitive assessment means that a definitive conclusion on a product frame of reference is not required in this case. In addition, although available evidence indicates a global geographic frame of reference, this analysis also looks at the impact of the acquisition on the UK.

46. The parties' post-merger share of revenue and contracts globally and in the UK in process services is below 20 per cent and therefore does not on a first look give cause for concern over potential unilateral effects. Whilst shares of supply for both pipeline services and well intervention services are higher, there are still a number of other suppliers for both types of service and bidding data shows that these suppliers have successfully bid against the parties for a number of major contracts. This bidding data also suggests that the parties do not often bid against one another for contracts in all three types of service, indicating that the merger would not represent the loss of a significant competitive constraint on either party.

47. Although responses from third parties indicate some barriers to entry may exist, assisted by growth of total UK revenues for all three types of service, there is evidence of entry in the supply of all three types of service, including one 'full-service' supplier. From evidence before the OFT, large customers are also in a strong negotiating position, with a significant share of the parties' purchases. Finally, no customers indicated that the merger would reduce their negotiating strength or leave them without a number of suitable alternative providers.

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

DECISION

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