Anticipated acquisition by Macquarie London Exchange Investments Limited of London Stock Exchange plc

The OFT's decision on reference under section 33(1) given on 3 February 2006. Full text of decision published 14 February 2006.

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. **Macquarie London Exchange Investments Limited** (MLX) is a newly created UK entity, which is ultimately controlled by **Macquarie Bank Limited** (MBL) through its wholly owned subsidiary, Macquarie European Financial Investments Pty Limited (MBLE), and its associated investment fund Macquarie Capital Alliance Group (MCAG), (through Macquarie Capital Alliance International Limited (MCAIL)).

2. **London Stock Exchange plc** (LSE) is a Recognised Investment Exchange under the Financial Services and Markets Act 2000. LSE demutualised in 2000 and became a listed UK plc in 2001. LSE's main business activities are: trading services in spot markets (which include listing and trading services); the generation and distribution of information products; and the development, implementation and operation of IT solutions for financial markets and market participants. The total turnover of LSE in the financial year ended 31 March 2005 was approximately £250 million.

TRANSACTION

3. On 15 December 2005, a consortium led by MBL and MCAG through MLX announced a cash offer for the entire issued share capital of LSE. In addition to MBL and MCAG there are four other financial investors involved in this

transaction: CQS LLP (CQS) [1], Centaurus Capital Limited (Centaurus) [2], Finpro SPGS, SA (Finpro) [3] and certain trusts controlled by Mr Matthew Perrin (the Perrin Trusts).

4. The top holding company of MLX is owned by three entities – MCAIL, Macquarie Financial Infrastructure Fund (MFIF) and Finpro Spain, which have shareholdings of 17.6 per cent, 67.6 per cent and 14.8 per cent respectively. MFIF is in turn owned by four entities – MBLE, Centaurus Master Fund, CQS Master Fund and the Perrin Trusts, which have shareholdings of 52.2 per cent, 21.7 per cent, 21.7 per cent and 4.4 per cent respectively. The overall structure of MLX and its holding companies is primarily determined by the terms of two shareholders' agreements. MBL has a controlling interest in MBLE, MFIF and therefore MLX.

5. However, other members of the bid consortium (Finpro Spain, Centaurus Master Fund and CQS Master Fund) may also be able materially to influence the affairs of MLX as a result of the level of their shareholdings in both the top holding company of MLX and in MFIF. In this instance, the OFT has not sought to reach a conclusion on whether any of these investors are able to exercise material influence over MLX because, regardless of the view taken, no overlap arises between the activities of these investors and that of the LSE.

6. MLX submitted a merger notice in relation to this transaction on 23 December 2005. The statutory deadline is 8 February 2006, following an extension of the period for consideration of the merger under section 97(2) of the Enterprise Act 2002 (the Act).

JURISDICTION

7. As a result of this transaction, enterprises carried on by or under the control of MBL and its associated fund, MCAG and the LSE will cease to be distinct. The UK turnover of the LSE exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

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[1] CQS will invest through CQS Convertible and Quantitative Strategies Master Fund Limited (CQS Master Fund)
[2] Centaurus will invest through Centaurus Alpha Master Fund Limited (Centaurus Master Fund)
[3] Finpro will invest through a wholly owned Spanish investment fund, Finpro Inversiones SL (Finpro Spain)

RELEVANT FRAME OF REFERENCE

8. The LSE's activities focus primarily on the provision of on-exchange equities trading services in the UK. The LSE has three principal sets of services: listing services, trading services and information services.[4]

9. At present, the LSE has no legal or economic interest in post-trade services (clearing and settlement) for equities traded on its exchange.

10. Since 2003 the LSE has also been a joint venture participant in EDX, a derivatives exchange based in London that trades futures and options in Scandinavian securities.

11. The Competition Commission (CC) considered the following relevant markets in its report on the proposed acquisition of the LSE by Euronext NV or Deutsche Börse AG[5] (CC's Report) which are relevant to the present assessment:

    a. The provision of listing services, which can be segmented further into:

    - The provision of primary listing services to domestic companies, which, in the case of the UK, includes only the LSE;
    - The provision of primary listing services to companies seeking listings outside of their domestic markets. This was considered to be international in scope; and
    - The provision of secondary listing services. This was considered to be international in scope.

    b. The provision of on-book equity trading services (which the CC distinguished from derivative trading and bond trading services). The CC considered that the geographic scope for the provision of these services includes Europe and the USA;

    c. The provision of (post trade) clearing services to the LSE. The CC viewed the provision of these services to be limited to the incumbent central counterparty, LCH.Clearnet; and

    d. The provision of (post trade) settlement services to exchanges. The CC considered the provision of these services to be national in scope.

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[4] For a further description of the LSE's activities, please refer to the OFT's decisions of 29 March 2005 regarding the proposed bids for the LSE by Deutsche Börse AG and Euronext NV.
[5] Deutsche Börse AG, Euronext NV and London Stock Exchange plc: A report on the proposed acquisition of London Stock Exchange plc by Deutsche Börse AG or Euronext NV, November 2005.

12. The CC did not find it necessary to conclude on the market definition for derivatives trading services or the provision of information services.

13. The OFT found no evidence during the course of its investigation which would suggest departing from the CC's analysis in this case. The OFT has therefore considered the provision of listing services, on-book trading services, clearing services and settlement services, as defined in the CC's Report and outlined above, as the relevant frames of reference to assess the impact of this merger.

HORIZONTAL ISSUES

14. MBL submitted that there is no horizontal overlap whatsoever between the activities of any member of the bid consortium (including the businesses of their relevant portfolio companies in which they may be deemed to have control or material influence) and the LSE. Therefore, this merger does not raise any horizontal issues.

VERTICAL ISSUES

15. MBL, in its capacity as an investment bank, has a vertical relationship with the LSE as it is a member of the latter for the purpose of being able to trade on the exchange.[6] However, MBL's trading activities are limited; its trades represent less than [0 per cent to 2 per cent] of total trades (by volume) on the LSE.

THIRD PARTY VIEWS

16. A few third parties raised concerns about this transaction. One such concern related to information exchange. In particular, there was a concern that if MBL were to acquire the LSE, it may be privy to certain trading and pricing information in relation to other market participants, which may distort competition in downstream markets. However, the Financial Services Authority (FSA) has confirmed that as a recognised investment exchange (RIE) under the Financial Services and Markets Act 2000 (FSMA), the LSE has to meet certain recognition requirements which cover, amongst other things, proper monitoring and enforcement and the promotion and maintenance of standards and safeguards for investors. The FSA would have regard to these requirements when assessing the scope for potential conflicts of interest, and it would expect the RIE to adopt adequate systems and controls to mitigate this risk.

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[6] Centaurus and CQS also have minor vertical links with the LSE which do not raise any competition concerns. As fund management entities, Centaurus and CQS place orders with brokers who trade on their behalf in shares that are listed on the LSE. In addition, Centaurus purchases an information service from the LSE for which it is required to pay an annual fee (estimated to be £540 per annum).

17. A couple of third parties raised concerns about the financial structure of the proposed acquisition, in particular the high gearing ratio. One third party was concerned that high levels of leverage may reduce incentives for innovation; in particular, the LSE would be less likely to enter neighbouring markets. However, even if the merger were to increase the LSE's incentive to focus on core activities rather than to expand into related areas, this may result in the LSE becoming a stronger competitor to other equity trading exchanges.

18. In addition, there was a concern that if MBL uses high levels of debt finance to acquire the LSE, this may cause a change in the LSE's incentives to invest in projects expected to yield long term returns. However, the CC's Report notes that other exchanges place a competitive constraint on the LSE and that liquidity could move elsewhere if the LSE does not remain competitive.

19. Another third party was concerned that although Macquarie does not currently control or have material influence over an existing clearing provider, there is a reasonable likelihood that such a provider would be established in the future to provide clearing services to the LSE. If the LSE were to establish its own clearing house, this may create an ability to foreclose competing UK exchanges from clearing services. However, irrespective of the merits of this argument, it is unclear that the LSE would have any greater incentive to establish a clearing provider under the ownership of MBL. Therefore this issue has not been considered any further.

20. The OFT also received some third party concerns in relation to future pricing levels for LSE users. In particular, there was a concern that prices may not be reduced in line with costs. However, the OFT did not receive any evidence to substantiate these concerns.

ASSESSMENT

21. The OFT has considered the relevant frames of reference to be the provision of listing services, on-book trading services, clearing services and settlement services, as defined in the CC's Report.

22. None of the members of the bid consortium (or any of the portfolio companies in which they may be deemed to have control or material influence) are active in any of the services provided by the LSE. Therefore, this merger does not raise any horizontal issues.

23. MBL has a vertical relationship with the LSE as it is a member of the latter for the purpose of being able to trade on the exchange. However, MBL's trades account for less than [0 per cent to 2 per cent] of the LSE's total trades (by volume). In

addition, there is a regulatory framework in place to mitigate any risks of a conflict of interest. Therefore, this vertical link does not raise competition concerns.

24. 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

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