OFFICE OF FAIR TRADING

Completed acquisition by The Thomson Corporation of TradeWeb Group LLC

The OFT's decision on reference under section 22 (1) given on 23 July 2004

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' or third parties' request.

PARTIES

The Thomson Corporation (Thomson) is a provider of integrated information solutions to business and professional customers in four market groups: Legal & Regulatory, Learning, Scientific & Healthcare and Financial. Through **Omgeo LLC** (Omgeo), its 50/50 joint venture with the Depository Trust & Clearing Corporation (DTCC), Thomson provides post-trade pre-settlement processing services for equities and fixed-income securities.

TradeWeb Group LLC (TradeWeb) was founded and operated as a joint venture between investment banks and other investors[1] to provide an electronic trading platform for fixed income securities.

TRANSACTION

Thomson has acquired TradeWeb for $385 million in cash plus substantial contingency payments. The transaction was announced on 8 April 2004 and completed on 21 May 2004. The 40-day administrative deadline expires on 23 July 2004.

JURISDICTION

Thomson and TradeWeb have ceased to be distinct enterprises. They overlap in post-trade processing of fixed income securities and 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 a relevant merger situation has been created.

[1] TradeWeb's equity owners were: CSFB [ ], Goldman Sachs [ ], Lehman Brothers [ ], Citigroup [ ], Merrill Lynch [ ], JP Morgan [ ], Deutsche Bank [ ] and Morgan Stanley [ ].

RELEVANT MARKET

Trading of financial instruments, including fixed income securities (e.g. government bonds) is comprised of three stages:

- **Trade execution**: buyer and seller agreeing to make a trade, often via brokers
- **Post-trade (pre-settlement) processing** (PTP): this stage can be split into distinct steps or functions
  - trade allocation – notification of the allocation instructions for the buy-side institution's accounts between the dealer and the buy-side institution for the securities to be purchased; for present purposes, the additional steps of 'affirmation' and 'confirmation' of the trade are treated as part of this function
  - *provision of standing settlement instructions* (SIS)– exchange of information between brokers/dealers necessary to the settlement of the trade
- **Settlement**: the closing of the trade which involves the transfer of ownership and title to the security in exchange for payment of the purchase price.[2] As neither party is active in this segment, it is not considered further.

Parties' products

The parties' PTP activities overlap by virtue of Thomson's 50 per cent interest in **Omgeo LLC**. Overlaps may be summarised as follows.

Trading function	Thomson product (via Omgeo)	TradeWeb product
Trade execution	N/A	*TradeWeb*
PTP: allocation	*Oasys*	*TradeXpress*
PTP: settlement instructions	*Alert*	*AccountNet*

Trade execution

TradeWeb is an electronic trade execution platform linking 24 fixed income securities (FIS) dealers with more than 1,500 buyers (buy-side institutions include institutional investors, hedge funds and asset managers) in North America and Europe, and essentially offers a request for quotation auction-style trading system in real-time (live quotes). As such, it is termed a 'business-to-customer multi-dealer' system. A wide variety of FIS are traded, including U.S. and European government bonds. TradeWeb also operates as an inventory-based execution system for some FIS: clients view and select from an inventory of securities and prices set by an individual dealer. It also provides users with market data for the liquid FIS traded on its platform.[3]

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[2] The delivery of securities (i.e. settlement) is typically carried out in a central securities depository (CSD) such as CrestCo or an International CSD such as Clearstream or Euroclear.
[3] 'eCommerce in the Fixed-Income Markets – the 2003 Review of Electronic Transaction Systems' conducted and compiled by the staff of The Bond Market Association.

PTP services

Thomson. Through Omgeo, Thomson provides PTP services through *Oasys* (trade allocation system) and *Alert* (settlement instruction system) products. *Oasys* is regarded as one of the most successful electronic trade confirmation businesses (supervised by the U.S. Securities and Exchange Commission) and handles large volumes of equities trades as well as FIS (Tradeweb's activities are limited to FIS).

TradeWeb. TradeWeb's UK presence in PTP is quite limited: its *TradeXpress* allocation system for FIS trades offered as a free ancillary service to trade execution, though a total of only [ ] buy-side customers made use of this service in the UK in 2003; its *AccountNet* product (a web-based standing settlement instruction data warehouse for FIS) [ ].

Product market

The three trading stages described above cannot be regarded as demand-side substitutes: all three are necessary to trade in FIS. On the supply side, it appears that many trade execution providers also provide PTP as an add-on service to some degree, because the additional marginal cost involved in providing PTP is very small. While this indicates some potential for supply-side switching from trade execution to PTP, those that have done so do not offer the breadth of functionality, for example, of Omgeo's *Oasys* and conversely, PTP specialists (such as Omgeo) have not branched into trade execution.

Trade execution

Trade execution has historically been performed manually via fax, phone and e-mail and still represents 75 per cent of bond trading. Although the parties submit that TradeWeb's electronic platform competes with manual methods of trade execution, customers have mixed views as to the constraint that manual methods place on electronic trading.

Within electronic trade execution, it is possible to distinguish three distinct business models or systems: business-to-customer single-dealer (B2C single-dealer), business-to-customer multi-dealer (B2C multi-dealer), such as *TradeWeb*, and inter-dealer (B2B) systems.[4] While B2C single-dealer systems allow investors to execute transactions directly with a specific dealer of choice, B2C multi-dealer systems provide customers with consolidated orders from two or more dealers and therefore with the ability to execute from among multiple quotes.[5] By contrast, B2B systems link the various investment banks allowing them to trade with each other.

Given the mixed evidence and complexity of the services at issue, it would be appropriate to proceed on the basis of the narrowest frame of reference identified, i.e. electronic B2C multi-dealer systems. However, there is no need to reach a final view due to the absence of competition concerns.

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[4] Auction systems and cross-matching systems also exist.

[5] 'eCommerce in the Fixed-Income Markets – the 2003 Review of Electronic Transaction Systems' conducted and compiled by the staff of The Bond Market Association.

PTP services

The vast majority of PTP for FIS trades takes place manually via fax, telex, telephone and e-mail. It can be conducted on a broker-to-broker basis or an institution-to-broker basis, this latter being much smaller. The focus of this analysis has been on overall electronic PTP services.

Geographic market

The parties submit that FIS are traded on a worldwide basis and that, as by its nature PTP is ancillary to trade execution, the relevant geographic market for both services is worldwide. Most third parties supported this view.

Some third parties cited the different suppliers in the United States and Europe[6] as reasons for a European frame of reference for both services; PTP tends to be more regional as it is restricted by the location of preferred clearing houses and custodians.

For the purposes of this decision, we regard the relevant geographic frame of reference for trade execution and PTP to be at least European in scope.

HORIZONTAL ISSUES

The parties do not overlap in trade execution.

PTP services

The parties overlap in trade allocation systems (*Oasys* and *TradeXpress*) and settlement instruction systems (*Alert* and *AccountNet*) for FIS trades, in particular, in relation to the institution-to-broker business.

The parties estimate that approximately 60 per cent of PTP for FIS trading still takes place manually via fax, phone and e-mail; the remaining 40 per cent is electronic (automated, e.g. EB). By combining manual and electronic means, the parties estimate their shares of supply for PTP for FIS trading in the UK to be [20-30] per cent for Omgeo and less than 1 per cent for TradeWeb. No third party estimates were available.

Of electronic-based PTP, the parties estimate that Omgeo accounts for about [70-80] per cent (i.e. [25-35] per cent of total PTP) and the other [20-30] per cent is accounted for by firms such as MarketAxess, FMC, SunGard and TradeWeb. Shares of supply in the segment relating to electronic institution-to-broker post-trade services are likely to be still higher.

Omgeo is currently the only provider of standalone allocation and SIS systems which can process trades executed electronically or through manual methods. The other systems named above provide PTP as a service ancillary to the transactions executed on their platforms. Oasys' functionality is also much greater than that of other systems

[6] See also 'eCommerce in the Fixed-Income Markets – the 2003 Review of Electronic Transaction Systems' compiled and conducted by the staff of The Bond Market Association, which suggests that there are many more electronic transaction systems for fixed-income securities available in North America than in Europe.

such as TradeWeb. TradeWeb, for example, does not provide an end-to-end solution whereby a customer can execute a trade, have it undergo PTP, and proceed seamlessly to actually settling the trade. At present, there is such a link between Bloomberg's trade execution platform and Omgeo's post trade processing services; no such connectivity currently exists between TradeWeb and Omgeo.

Notwithstanding its limited current position, certain third party respondents suggested that TradeWeb was seriously considering expanding its PTP services (by, among other things, perhaps seeking SEC approval to 'match' trades) which would have brought it into greater competition with Omgeo.

In response, the parties argued, cogently, that TradeWeb's expansion in PTP lacked the status of a well-developed plan [ ]. Moreover, all those third parties that did raise the issue of potential competition also regarded the merger of the parties' largely complementary activities as bringing benefits.

In the light of this, the OFT considers that a theory of harm based on loss of potential competition in PTP lacks sufficient evidentiary basis and is accordingly too speculative to form a basis for the OFT's statutory belief under section 22 of the Act.

Barriers to entry

Third parties support the parties' view that there are no technological barriers for a firm active in trade execution to expand into PTP services. Competitors identify access to pools of stock liquidity and the difficulty in rapidly creating a user community as the main barriers. In addition, there are certain switching costs (such as investment in new technology and the implementation of new processes) involved in moving from one PTP provider to another which could discourage new entrants. There have been no significant examples of new entry in PTP, though a few vendors are in the process of trying to develop their straight-through-processing solution offerings.

Buyer power

The evidence and views of market participants were mixed on this issue of buyer power. Accordingly, it is appropriate not to rely on this as a constraint on the merged entity.

CONGLOMERATE ISSUES

Third parties have alleged that the complementary nature of trade execution and PTP services leads to foreclosure concerns. The primary source of these alleged concerns may be summarized as resting on the following propositions:

- Omgeo (and thus Thomson) has market power in relation to PTP because it controls *Oasys*

- By acquiring TradeWeb, Thomson could leverage that power by denying access to *Oasys* to parties that did not execute their trades on *TradeWeb* (in other words, tie the supply of trade execution services to its PTP services)

- Thomson would have the incentive to do so because demand for electronic trading is growing and such action would facilitate migration of manual

customers to TradeWeb at the expense of rivals, while also increasing barriers to entry (as new entrants would have to develop both PTP and trade execution services to provide an end-to-end solution to compete).

Ability to foreclose

It is uncontested that Omgeo is the only significant stand-alone electronic PTP services provider for FIS and *Oasys* enjoys widespread usage. To the extent it faces a direct competitive constraint, this would be expected to originate from other electronic providers, but these tend to be offered as a service ancillary to trade execution. While a significant portion of manual PTP has shifted to electronic, it is not clear that customers would switch back to manual, thus casting doubts on manual methods as a constraint on Omgeo.

The evidence presented on Omgeo's ownership and governance structure, however, casts significant doubt both on whether Omgeo has market power and whether Thomson is able to leverage this power and thus able to foreclose. First, the OFT understands that many of Omgeo's major customers – investment banks – are on Omgeo's board and constrain simple majority decision making on pricing and other competitive variables; doubts therefore remain as to whether Omgeo can charge supra-competitive prices (i.e. has market power)[7]. Second, these customers and the other shareholder, the DTCC, would appear to be able to prevent Thomson from unilaterally altering Omgeo's business model, which is predicated on vendor neutrality (i.e. no distinctions based on the source of the executed trade) in order to capture the maximum number of transactions.

Incentives to foreclose

Assuming for present purposes an ability to foreclose, Thomson has submitted a variety of reasons why Omgeo and/or itself nonetheless lacks the incentive to do so. Two arguments appear the most compelling.

First, the other decision-makers within Omgeo have no incentives to enhance Thomson's revenue in trade execution, as they would receive no benefit; to the contrary, over 50 firms' systems use Omgeo for PTP and any attempt to foreclose them would reduce Omgeo's revenues more than could be gained from increased business through a single platform, TradeWeb.

Second, Thomson's own profit-maximising strategy will be to attract manual execution customers without conditions attached. While the OFT does not regard this benefit as merger-specific, Thomson's stated intent to offer connectivity between TradeWeb and Oasys to replicate that already enjoyed by Bloomberg's trade execution system is consistent with its overall rationale for the acquisition, which was to acquire a greater presence in the sector as a whole, and particularly FIS, by acquiring TradeWeb's largely complementary (trade execution) business.

Thomson also argued it lacked the requisite incentives because customers would punish

[7] The board is comprised of two members from the DTCC, two members from Thomson, and seven customer representatives (four of which are nominated by the DTCC and three by Thomson).

attempts to foreclose by shifting business away (in trade execution and PTP but also in the 'upstream' sector pre-trade analytics) and/or sponsoring entry themselves. This argument is not supported by customers, many of whom believe there is no realistic alternative to Omgeo.

Additional concerns

An alternative theory of foreclosure in trade execution put to the OFT was based on the deferred consideration payable to TradeWeb's former shareholders annually for three years under the purchase agreement if certain revenue targets are met. The concern was that this would provide these eight large investment banks with the incentive to place more business with TradeWeb and not its competitors. The parties submit that the maximum earn-out broadly corresponds with the expected distributions to the former shareholders for the next three years.[8] The purchase agreement does not require any former shareholder to deal exclusively with TradeWeb in any way. In any event, it is likely that the incentives placed on the previous owners to use TradeWeb by virtue of the earn-out clause are presumably less (and certainly no more) than the incentives they had as shareholders to use their own joint venture vehicle (this being the rationale for founding TradeWeb). Accordingly, the acquisition cannot be said to increase incentives to foreclose under such a theory.[9]

A final concern raised was that the acquisition might lead Thomson to stop using third party data sources for its International Financial Review (IFR)[10] and simply use TradeWeb's information. However, the acceptance of IFR depends on its use of the best data available in the market and it is important that authors have access to multiple sources of data to cross-check accuracy. Given this, it seems unlikely that Thomson would have any incentive to stop using third party sources of data. Furthermore, it appears that IFR faces strong competition from other publications and therefore Thomson would not be in a position to foreclose the supply of such information in the publications sector.

Conclusion

The weight of overall evidence suggest that the conglomerate concerns arising from this merger are not sufficiently well-founded as to justify the OFT's statutory belief for reference under section 22 of the Act. The OFT considers there to be no realistic prospect that Thomson has both the ability and incentives to foreclose rivals in trade execution and thus ultimately harm consumers. Many third parties have commented that the merger will bring them benefits of using a single platform, which will reduce their own transaction costs.

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[8] In 2004, there was a distribution of [ ] on 24 March and a special distribution, in connection with the closing of [ ].

[9] A linked concern from a customer related to alleged favourable treatment afforded by TradeWeb to its owner banks. For the purposes of merger assessment, the de-coupling of TradeWeb from its former owners through sale to Thomson would not increase incentives to favour certain customers over others.

[10] This provides market analysis on a wide range of topics for the international capital markets.

THIRD PARTY VIEWS

The majority of third parties were unconcerned about this merger.

Two competitors raised concerns about possible integration between Omgeo and TradeWeb, their fear being that this could foreclose their own access to Omgeo. Customers in general were not concerned, although a few raised concerns about a loss of potential competition between TradeWeb and Omgeo in PTP. Many customers commented that there could be benefits to the merger.

ASSESSMENT

The parties overlap in the supply of PTP services for FIS trading. The increment is minimal, and the level of competition between the parties is slight. Although conceivable that TradeWeb would have expanded its presence and competed more substantially absent the merger, the evidence supporting this is no more than speculative.

As trade execution and PTP services are highly complementary, third parties have raised a variety of foreclosure concerns. The evidence gathered does not support the proposition that Thomson has either the ability or incentives to foreclose rivals, in particular, by tying access to Omgeo's PTP services to TradeWeb's trade execution platform.

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

DECISION

This merger will therefore not be referred to the Competition Commission under section 22 (1) of the Enterprise Act.