

Completed acquisition by Arlingclose Limited of Sterling Consultancy Services

ME/5803/12

The OFT's decision on reference given on 1 February 2013. Full text of decision published 6 February 2013.

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

PARTIES

1. **Arlingclose Limited (Arlingclose)** provides treasury management advisory (**TMA**) services to UK local authorities and other public sector bodies, both on a retainer and one-off basis. Arlingclose's total UK turnover for the financial year ended 30 June 2012 was approximately £[] million.
2. **Sterling Consultancy Services (Sterling)** was a division of Sterling International Brokers Limited, itself a subsidiary of Skipton Building Society. The Skipton Group has significant interests in estate agency and related businesses, financial services outsourcing, independent financial and related advisory businesses and support services. Prior to the merger, Sterling provided TMA services to UK local authorities and other public sector bodies, both on a retainer and one-off basis. Sterling's total UK turnover for the financial year ended 31 December 2011 was approximately £[].

TRANSACTION

3. On 18 October 2012, for a consideration of £[], Arlingclose and Sterling entered into and completed a Sale and Purchase Agreement. Arlingclose acquired [] TMA services contracts with local authorities, [] TMA

contracts with other public authorities, charities and building societies, records associated with these contracts and two employees under the TUPE regulations.¹

4. The Office of Fair Trading (**OFT**) opened an investigation into the merger on 2 November 2012. The statutory deadline is 18 February 2013 and the administrative deadline is 1 February 2013.

JURISDICTION

5. A relevant merger situation arises when two or more enterprises cease to be distinct and either the UK turnover test or share of supply test set out in Section 23 of the Enterprise Act 2002 (the **Act**) is met.

Enterprises ceasing to be distinct

6. The term 'enterprise' is defined in Section 129 of the Act as '**the activities, or part of the activities, of a business**'. The OFT's guidance provides information on the factors that it considers relevant in determining whether an 'enterprise' has been transferred.² The OFT believes that the transfer of assets, customer contracts and staff constitute an 'enterprise' for these purposes. The OFT believes that the merger led to the transfer of Sterling's TMA services business and allowed Arlingclose to take over the supply of these services to customers of Sterling.
7. Therefore, the OFT believes that two or more enterprises have ceased to be distinct since, as a result of this merger, Arlingclose has ceased to be distinct from Sterling's TMA services business.

Share of supply test

8. The parties overlap in the supply of TMA services to UK local authorities on a retained basis. Arlingclose submitted that there are currently a total of 450 local authorities in the UK and the parties combined have contracts with [] local authorities. This equates to a combined share of supply of [under 25] per cent.

¹ Transfer of Undertakings (Protection of Employment) Regulations

² OFT Mergers – jurisdictional and procedural guidance (OFT527), paragraph 3.10.

9. However, the OFT has been provided with data relating to the number of local authorities that currently have TMA retainer contracts in place. Of these, the parties have a combined share of [over 25] per cent (see Table 1 below). Therefore, the OFT considers that the share of supply test in section 23(2) of the Act is satisfied.
10. The OFT therefore believes that it is or may be the case that the merger has resulted in the creation of a relevant merger situation.

COUNTERFACTUAL

11. As set out in its Merger Assessment Guidelines, the OFT considers the effect of a merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In practice, in completed mergers, this will generally be the pre-merger situation, unless the OFT considers that the prospect of those conditions continuing was not realistic. This may be, for example, because the OFT believes that one of the merger firms would inevitably have exited from the market.³ Arlingclose submitted that the counterfactual should be that, absent the merger, Sterling would have exited the market.

Exiting firm scenario

12. In forming a view on an exiting firm scenario, the OFT will consider:
 - i. whether the firm would have exited (through failure or otherwise) and, if so,
 - ii. whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration and
 - iii. what would have happened to the sales of the firm in the event of its exit.

³ OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.5.

Exit of Sterling

13. The first step in assessing the appropriate counterfactual is for the OFT to consider whether Sterling would have exited the market absent the merger.⁴
14. Arlingclose submitted that Sterling International Brokers Limited, the parent company of Sterling, chose to dispose of Sterling because of its recent poor performance and its inability to fill key vacancies. [].
15. However, the OFT also notes Sterling's TMA services business had a turnover of around £[] last year, approximately £[] of which was derived from retainer contacts with local authorities. Based on the evidence presented to the OFT by the parties, it is not clear that Sterling's TMA services business was making a substantial loss.
16. Prior to the merger, two members of staff left Sterling, including the head of Sterling who joined Arlingclose in July 2012. In mid-September 2012, a second member of staff left Sterling to join Sector Treasury Services Limited (**STS**). Arlingclose submitted that Sterling was left with just two employees, [].⁵ Arlingclose submitted that Sterling sought and failed to recruit new suitably qualified employees.
17. The OFT has not seen compelling evidence that Sterling would have inevitably exited the market nor would have been unable to replace the two members of staff who left in the absence of the merger. The OFT has therefore not found it necessary to consider the remaining limbs of the exiting firm scenario.
18. Consequently, the OFT believes it is appropriate to adopt the pre-merger situation as the counterfactual.⁶

⁴ OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraphs 4.3.13–4.3.15.

⁵ The Chartered Institute of Public Finance and Accountancy (CIPFA) is the relevant professional accountancy body specialising in public services. Although CIPFA qualification is not needed to provide TMA services, CIPFA qualified staff numbers or ratios are often a feature of tender questions from local authorities.

⁶ The counterfactual includes that Sterling would have replaced the two members of staff who left.

FRAME OF REFERENCE

19. Arlingclose and Sterling overlap in the supply of TMA services to UK local authorities and other public sector bodies.

Product scope

Local authorities/other public authorities

20. Arlingclose submitted that the product frame of reference should include the provision of TMA services to local authorities and other public authorities such as police, transport, passenger and national park authorities. This is because these other public authorities hold contracts for the same TMA services that are provided to local authorities, and that these public authorities are required to comply with the same highly specific legislation and accounting requirements as local authorities.
21. However, in *STS/Butlers*, although the Competition Commission considered whether other public authorities should be included within the relevant market, it concluded that they should not, because the parties were not constrained by suppliers of TMA services which only provided services to those other types of public authority.⁷

Retainer contracts/one-off contracts

22. TMA services can either be provided on a retainer contract, the duration of which is usually between two and five years, or on a one-off assignment basis.
23. Arlingclose submitted that it agrees with the frame of reference set out by the Competition Commission in *STS/Butlers*. The Competition Commission said that the market for one-off contracts was mostly an aftermarket, on the basis that in most cases such contracts were arranged with the supplier of the TMA retainer. The Competition Commission therefore did not separately consider the effect of the merger on one-off contracts.

⁷ Competition Commission 'A report on the completed acquisition by Sector Treasury Services Limited of ICAP PLC's treasury management advisory services business (Butlers)', 31 August 2011, footnote 30.

24. Based on the evidence available to it, the OFT does not consider the market has materially changed since the Competition Commission's findings. It therefore takes the same view as the Competition Commission in *STS/Butlers* with regard to one-off contracts and to contracts with other types of public authority.

Geographic scope

25. Firms provide TMA services to local authorities across the UK. Arlingclose submitted it has never encountered significant difficulties in providing TMA services to a customer in a particular region, as a result of not having a presence in that region. On the contrary, some of Arlingclose's customers have expressed a preference for Arlingclose to be close to London due to the proximity to financial markets.
26. The Competition Commission also adopted the UK as the relevant geographic frame of reference in *STS/Butlers*. None of the responses from third parties indicated that an alternative geographic frame of reference should be used.

HORIZONTAL ISSUES

Shares of supply

27. Market shares of firms in the market, both in absolute terms and relative to each other, can give an indication of the potential extent of a firm's market power. The combined market shares of the merger firms, when compared with their respective pre-merger market shares, can provide an indication of the change in market power resulting from a merger. In horizontal mergers in markets involving undifferentiated products, unilateral effects are more likely where the merger results in a firm with a large market share.
28. Table 1 shows the market share in terms of volume and revenue of the parties and STS.

Table 1: Market shares for TMA services retainer contracts to local authorities⁸

	Volume		Revenue	
	Contracts	Share (per cent)	Revenue (£ million)	Share (per cent)
STS	[]	[65 -75]	[]	[65-75]
Arlingclose	[]	[15-25]	[]	[20-25]
Sterling	[]	[5-15]	[]	[5-10]
Total	[]	100	[]	100

29. This merger involves a reduction in the number of suppliers from three to two. However, Sterling had a share of supply of five to eight per cent (depending on whether value or volume measures are used), making it the smallest supplier in the marketplace. This share indicates that Sterling may not have been a strong competitor against either Arlingclose or STS.
30. In *STS/Butlers*, the Competition Commission noted there was some differentiation between the three firms on the basis of price and quality. The Competition Commission agreed with Sterling’s assessment that Arlingclose was perceived to be an average to high quality, high price operator and that Sterling was an average quality, low price operator.⁹ The Competition Commission also found that Sterling focused on lower priced contracts and does not offer the same depth and breadth of services as Arlingclose or STS.¹⁰
31. Customers have differing views as to the degree of substitutability between Arlingclose and Sterling. Some customers indicated that the parties were close competitors, while a number of customers indicated that Arlingclose offers a higher quality and a more comprehensive service. Arlingclose holds a larger share of the market on a revenue basis than it does on a volume basis. The opposite is true for Sterling. This evidence is

⁸ Source: Data for volume provided by STS (correct as of December 2012) and the parties (correct as of Oct 2012). Data for revenue provided by STS (revenue from local authority contracts in 2011) and the parties (annual value at the time of the merger).

⁹ Competition Commission ‘A report on the completed acquisition by Sector Treasury Services Limited of ICAP PLC’s treasury management advisory services business (Butlers)’, 31 August 2011, Appendix F, paragraph 3.

¹⁰ Competition Commission ‘A report on the completed acquisition by Sector Treasury Services Limited of ICAP PLC’s treasury management advisory services business (Butlers)’, 31 August 2011, Appendix F, paragraph 47.

consistent with Arlingclose offering a service which is higher in price, and possibly quality, than Sterling.

32. Two customers indicated that Arlingclose offers investment advice and information while Sterling and STS offer only information. This is consistent with the evidence presented to the Commons Select Committee inquiry.¹¹ Other customers noted that, contrary to STS and Sterling, Arlingclose does not take commissions or share fees with counterparties, and that such independence is a crucial aspect of receiving sound investment advice.
33. Based on the evidence provided to the OFT, it does not consider that Arlingclose and Sterling are close competitors in the market.
34. In addition, Arlingclose submitted win-loss bidding data for the three year period from 2010 to 2012. The data covered 166 TMA retainer contracts for which at least one of the parties bid. Arlingclose bid on 92 per cent of the tenders, and Sterling bid on 58 per cent. The parties' bids overlapped on 83 tenders, which amounts to 86 per cent of the contracts Sterling bid on and 54 per cent of the contracts that Arlingclose bid on. This indicates the parties overlapped to a significant extent during this time period.
35. The data also indicate that there is an incumbency advantage in bidding for tenders, with incumbents winning at least 60 per cent of the contracts. In *STS/Butlers* the Competition Commission also found that tender award patterns were consistent with an incumbency advantage, with incumbents retaining 75 per cent of their contracts. Neither the bidding data provided by Arlingclose nor the bidding data from *STS/Butlers* suggest that the parties are particularly close competitors. For example, Sterling has won only 10 contracts for which it was not the incumbent since 2009, none of which were previously held by Arlingclose. Similarly, Arlingclose has won only one contract of the 12 that it bid where Sterling was the incumbent. Therefore, the bidding data indicate that the parties were not close competitors. The data on bids provided by customers in response to the OFT's inquiries is consistent with this conclusion.

¹¹ House of Commons, Communities and Local Government: Local authority investments, Seventh Report of Session 2008–09, HC 164-I, 12 May 2009, page 36.

Barriers to entry and expansion

36. In assessing whether entry or expansion might prevent a substantial lessening of competition from occurring, the OFT will consider whether such entry or expansion would be:
- i. timely
 - ii. likely and
 - iii. sufficient.¹²
37. Arlingclose submitted that other companies who provide outsourcing services to local authorities could enter the market if they chose to. Arlingclose listed recent attempts by accountancy firms and other financial advisors to win tenders in recent years, and submitted that similar attempts could conceivably be made to enter in the future.
38. Arlingclose estimated that it would cost approximately £[] and take five months between planned inception and entry for a firm to switch from providing TMA services to private firms to providing TMA services to local authorities. Arlingclose estimated that it would take approximately three years to recover the investment.
39. Furthermore, Arlingclose estimated that it would cost approximately £[] and take one month between planned inception and entry for a firm to switch from providing TMA services to other public authorities to providing TMA services to local authorities.
40. In *STS/Butlers*, the Competition Commission found that the market for the provision of TMA services to local authorities did not appear to be characterised by frequent entry. Neither the financial advisers nor the large accountancy firms exercised or were likely to exercise a strong competitive constraint on the current providers of TMA services to local authorities. Other barriers to entry identified by the Competition Commission included difficulties in obtaining sufficient staff with the right expertise and experience, and difficulties in winning tenders without a track record in the market. Self-supply was unlikely to be an effective constraint.

¹² OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.8.3.

41. The OFT has not been provided with sufficient evidence to suggest that the situation outlined by the Competition Commission has changed. However, given that the OFT's decision is not contingent on whether or not there are barriers to entry, it does not need to conclude on the issue.

Conclusion on unilateral effects

42. This merger involves the combination of the two smaller firms in a three firm market. A minority of third parties who responded to the OFT's inquiries raised concerns, mostly relating to a potential reduction in choice and competition. The parties to the merger are differentiated by price and quality of their services, and so are not close competitors for all customers.
43. On balance, the OFT considers that Sterling could only be expected to have offered a very limited competitive constraint on Arlingclose and STS. On this basis, the OFT does not consider there is a realistic prospect of unilateral effects which would give rise to a substantial lessening of competition.

THIRD PARTY VIEWS

44. The majority of third parties that provided responses to the OFT as a result of its enquiries did not have concerns. Of the third parties that were concerned, the vast majority of these were former Sterling customers. Their concerns mostly related to the reduction in choice and potentially competition, particularly for customers preferring a lower price and quality mix. The OFT considers that these concerns are alleviated by the fact that the parties were not close competitors and that STS remains in the market offering relatively low priced contracts.
45. Any other specific third party comments have been incorporated where relevant in the decision.

ASSESSMENT

46. The parties overlap in the supply of TMA services to local authorities and other public authorities across the UK. Such services can either be provided under a retainer contract or on a one-off assignment basis. Drawing primarily on the conclusions of the Competition Commission in the

STS/Butlers case, the OFT has assessed the current merger on the basis of the supply of TMA services to local authorities under retainer contracts across the UK.

47. While the OFT accepts that Sterling may have been in a weak competitive position prior to the merger, it has not been provided with compelling evidence that Sterling would have inevitably exited the market in the absence of the merger.
48. This merger involves the combination of the two smaller firms in a three firm market. However, the parties to the merger are differentiated by price and quality of their services, which indicates that the parties were not close competitors. Both the bidding data provided by Arlingclose and provided to the Competition Commission in *STS/Butlers* corroborates this. Given that the parties were not close competitors, and given Sterling's weak competitive position prior to the merger, the OFT considers that Sterling could only be expected to have offered a very limited competitive constraint on Arlingclose. On this basis, the OFT does not consider there is a realistic prospect of unilateral effects which would give rise to a substantial lessening of competition.
49. Although some third parties did raise concerns relating to the reduction in choice and potential competition in the market as a result of the merger, the majority of third parties were not concerned.
50. 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

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