

Completed acquisition by Brookfield Infrastructure Partners LP of  
Inexus Group Limited

**ME/5620/12**

The OFT's decision on reference under section 22 given on 25 October 2012.  
Full text of decision published 1 November 2012.

---

**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. Brookfield Infrastructure Partners LP (**Brookfield**) is a global infrastructure investor listed on the New York Stock Exchange and Toronto Stock Exchange. The Brookfield business relevant to this transaction is the Gas Transportation Company Limited (**GTC**), which is an independent utility connections provider. GTC installs gas and electricity connections and adopts and operates the relevant assets, pursuant to Independent Gas Transporter (**IGT**) and Independent Distribution Network Operator (**IDNO**) licences from the Office of Gas and Electricity Markets (**Ofgem**).
2. In the financial year ending 31 December 2011, Brookfield generated a worldwide turnover of \$1,636 million (equivalent to circa [£1,061 million]).
3. Inexus Group Limited (**Inexus**) is an independent utility infrastructure provider, which historically focused on gas and electricity connections for new housing developments and is currently pursuing a multi-utility strategy.<sup>1</sup> Inexus holds IGT and IDNO licences. Inexus is also capable of installing water networks and holds inset water appointments from the Water Services Regulation Authority (**Ofwat**) for assets at several sites

<sup>1</sup> As described in paragraph 7 below.

(enabling it to adopt and operate water assets). Inexus was purchased by a consortium led by Challenger Infrastructure Fund (**Challenger**) in 2005.

4. In the financial year ending 30 June 2011, Inexus generated a UK turnover of £63 million.

## **TRANSACTION**

5. On 19 October 2012, Brookfield acquired 100 per cent of the share capital of Inexus from Challenger and other minority stakeholders of Inexus (the **Transaction**). The Transaction has given Brookfield de jure control of Inexus (together, the **Parties**).
6. On 30 August 2012, the Parties notified the Transaction to the OFT by way of informal submission, as an anticipated transaction at the time. By way of administrative deadline, the OFT endeavoured to reach a decision in this case by no later than 25 October 2012. Following the completion of the Transaction on 19 October 2012, the statutory deadline for the OFT's decision in this case is 19 February 2013.

## **RATIONALE**

7. Brookfield submits that it has several reasons for pursuing the Transaction, as detailed below:
  - The addition of Inexus' existing installed base to GTC's installed base will increase the revenues that GTC receives on an ongoing basis. Inexus has largely been valued on the basis of these revenue flows.
  - Brookfield aims to extract synergies by combining certain functions of Inexus and GTC.
  - The combined entity will be able to pursue more cost effective financing structures, such as a capital markets bond issue, which in practice requires certain scale thresholds to be met.
  - Inexus' multi-utility strategy, whereby Inexus targets larger developments and seeks to sell a wider bundle of products (including district heating, electricity, water and fibre connections) will provide

GTC with access to a new growth platform, complementing and diversifying GTC's focus on gas and electricity connections.

## **JURISDICTION**

8. As a result of the Transaction Brookfield and Inexus ceased to be distinct.
9. As set out above, the UK turnover of Inexus in the financial year ending 30 June 2011 was £63 million. Consequently, the turnover test in section 23(1) of the Enterprise Act 2002 (the **Act**) is not met.
10. The Parties are both active in gas installation activities, and they submit that they have a combined share of supply of around [30-40] per cent of gas installations to new build housing developments in the UK. Consequently, the share of supply test in section 23(2) of the Act is satisfied.

## **FRAME OF REFERENCE**

### **Background**

11. When a housing developer builds new homes, those homes need to be connected to the existing utility networks in order for the residents to receive utility services. The term 'connections' in this decision refers generally to such infrastructure.
12. In gas and electricity these connections for the 'last mile' before reaching a home were traditionally provided exclusively by the incumbent regional monopolist: for gas, the local Gas Distribution Network (operator) (GDN) and for electricity, the Distribution Network Operator (DNO). However, since 1995 (for gas) and 2000 (for electricity) these activities have been open to competition.
13. Connecting a home to a regional gas or electricity network involves (i) installing the pipes/cables and other necessary assets (such as gas governors and electricity substations) to link the home(s) to the existing network (installation) and (ii) 'adopting' those assets as a relatively small

network, embedded within the incumbent's network, to be operated and maintained by the adopting licensee for the future (adoption).<sup>2</sup>

14. Installation and adoption are two separate activities: installation is largely a construction activity which can be completed quite quickly, and is lightly regulated. Adoption involves taking responsibility for operating and maintaining the new network going forward, and requires a licence from Ofgem. The terms adopter and operator are used interchangeably for the purposes of this decision.
15. Installers will either adopt infrastructure themselves or will partner with an adoption service at the time when they bid for work from a developer. As such, although the installation and adoption elements can appear to the developer to be a single installation package, it can be performed by two separate companies.
16. New homes may be built as part of a housing development, requiring a new network to connect multiple homes, or as 'one-off' individual homes (that is, an individual domestic property on an existing street or development that requires a new connection). Connections may also be made to existing homes that do not already have a connection (this typically only applies to gas connections). The process described above for connecting homes applies to all of these new connections.
17. A similar process applies to new connections to industrial and commercial sites, except where connections are made directly to the transmission network (for example, the largest industrial and commercial connections). In the latter cases, the connections can only be installed by the operator of the transmission network.
18. From the point of view of the customer there are three types of businesses that provide gas and electricity connections services, as detailed below:
  - The incumbent (GDN/DNO) which can install and adopt the connecting pipes/assets.
  - Independent distribution companies (that is, IGTs in gas and IDNOs in electricity) which can install and adopt the connecting pipes/assets.

<sup>2</sup> The terms adopter and operator are used interchangeably for the purposes of this decision.

The installation would usually be done by the IGT/IDNO's affiliated connections provider (known as a Utility Infrastructure Provider (**UIP**) in gas and an Independent Connections Provider (**ICP**) in electricity), with the IGT/IDNO subsequently adopting the assets pursuant to licences granted by Ofgem. Both GTC and Inexus have IGT and IDNO businesses, with affiliated UIP and ICP businesses.

- Third party UIPs/ICPs can install the connecting pipes/assets but cannot adopt them. The UIP/ICP would typically arrange for the assets to be adopted once installed, either by a GDN/DNO or by an IGT/IDNO.

19. Ofgem has sought to promote competition in installation and adoption, in both gas and electricity. Ofgem also undertakes a biannual review of the connections industry with the most recent report covering the 2009-2010 period published on 28 March 2011 (the **Connections Industry Report**).<sup>3</sup>
20. Competition in gas connections (including both installations and adoptions) is now well developed: in 2009-10 the proportion of gas connections installed by GDNs or their affiliates had dropped to 41 per cent. By contrast, the vast majority of electricity connections (88 per cent) are still installed by DNOs or their affiliates.<sup>4</sup>

### **Product scope**

21. The OFT has not previously reviewed a transaction involving providers of 'last mile' infrastructure connections. In *E.ON/ABB*,<sup>5</sup> the OFT reviewed the transaction on the basis of 'contestable street light connections, installations and maintenance/repair', but did not need to conclude as no competition concerns arose. In its investigation into *ENW*, a case under Chapter II of the Competition Act 1998 relating to the electricity sector, Ofgem considered the market for 'building or adoption and operation of

<sup>3</sup>[www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=55&refer=Networks/Connectns/ConnlndRev](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=55&refer=Networks/Connectns/ConnlndRev)

<sup>4</sup> Connections Industry Report, page 11.

<sup>5</sup> *Anticipated acquisition by E.ON UK plc of the public lighting business of ABB Holdings Limited and ABB Limited*, OFT, 16 May 2008.

newly constructed electricity networks' but did not have to reach a conclusion on the appropriate definition for this market.<sup>6</sup>

22. The Parties are both active in the provision of gas and electricity connections services. The OFT has considered in this case whether it is appropriate to segment the market in any of the ways described below, namely:<sup>7</sup>

- segmentation by type of installation (gas/electricity)
- segmentation by installers/adopters
- segmentation by customer group (individual homes/multiple housing),  
or
- segmentation by type of connection (domestic/non-domestic).

23. It is important to note that market definition is a useful tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the OFT analysis of the competitive effects of the merger in any mechanistic way.<sup>8</sup> For the purposes of the current assessment, the OFT does not consider it necessary to come to a firm conclusion as to the precise product scope given that, on the basis of the evidence presented to it, no competition concerns arise in any possible frame of reference.

#### **Segmentation by type of installation (gas/electricity)**

24. The Parties submit that separate markets exist for gas and electricity connections, due to differing licensing requirements for adopting assets and differing technical considerations for installing them. The Parties submit that this is in line with previous decisions by Ofgem.

<sup>6</sup> See *Decision to accept binding commitments from Electricity North West Limited over connection charges*, Ofgem, 24 May 2012, paragraphs 3.30 to 3.37.

<sup>7</sup> Further, the OFT understands that the Parties have, or may have had in the past, some overlaps in the provision of other utility infrastructure, namely fibre networks, water connections, district heating connections and solar panels. As explained in paragraphs 84 to 90 of this decision, no competition concerns arise in any of those areas. The OFT has therefore not considered necessary to describe a precise frame of reference in relation to those areas.

<sup>8</sup> OFT/CC Joint Merger Assessment Guidelines (the Merger Assessment Guidelines), paragraph 5.2.2.

25. While the OFT has not had to reach a definite conclusion on market definition, on a cautious basis the OFT has considered the effects of the Transaction with regard to gas and electricity segments separately.

### **Segmentation by installers/adopters**

26. The Parties submit that installation and adoption services represent separate but linked services. Since both companies are active in installations and adoptions, the OFT has considered whether these services represent separate markets.
27. The Connections Industry Report indicates that there are different regulatory requirements for installers and operators of assets, with only licensed companies allowed to operate installed assets, whereas assets can be installed by non-licensed companies. The Connections Industry Report states that 'connection installation and asset operation are two distinct activities, with different but related competitive dynamics.'
28. The Parties submit that installers and operators should be in different economic markets. To support this view, they submit as follows:
- Some participants are active only in installation (for example various UIPs and ICPs) whereas others are active only in adoptions (for example E S Pipelines (**ESP**)).
  - There are different skills/requirements for adoption (a licensable activity) than for installation (non-licensable, but does require technical awards).
  - Whilst adopting assets is an input into the quotation given for installation, adoption is in itself a competitive process.
  - Given the context of Ofgem's investigations, and its Connections Industry Report, it appears that Ofgem considers the installation and adoption aspects of connections separately.
29. The relevant product market is identified primarily by considering the response of customers to an increase in the price of one of the products of

the merger firms (demand-side substitution).<sup>9</sup> Although the end product is a connection provided to an individual home owner or a developer, operators and installers may have different customers in relation to the same asset.

30. The Parties submit that when a developer asks for a connection from an installer who is not a licensed operator (or does not want to operate the network), the installer will 'tender' the connection to operators who will pay them to adopt the asset. The installer will then base their quote to the developer on the installation cost and the payment for adoption, and will secure a binding agreement with the operator for the purchase of the asset at the earliest opportunity. Therefore, although the markets are vertically linked (and companies may be vertically integrated) a SSNIP<sup>10</sup> by a hypothetical monopolist of either installers or operators would not lead to switching outside each of these narrowly defined markets, as each provide a different service to a different customer.
31. On a cautious basis, the OFT has considered whether competition concerns arise within each of the adoption segment (that is, provision of adoption services to third party installers) and installation segment (provision of installations to installation customers, typically developers) for each of gas and electricity.

#### **Segmentation by customer group (individual homes/multiple housing)**

32. The OFT has considered whether a segmentation by customer group would be appropriate.
33. The Parties submit that GDNs/DNOs tend to have a greater presence in one-off connections, which are typically to smaller customers. The OFT understands that one reason for this is that GDNs/DNOs are not able to ascribe any value to the assets,<sup>11</sup> which in turn would affect their bid for large domestic contracts.
34. The OFT contacted third party construction customers and competitors of the Parties to ascertain whether they believe GDNs/DNOs are able to bid

<sup>9</sup> Merger Assessment Guidelines, paragraph 5.2.7.

<sup>10</sup> Small but significant and non-transitory increase in price (Merger Assessment Guidelines, paragraph 5.2.11).

<sup>11</sup> This is due to the regulatory regime applicable to GDNs/DNOs, as the OFT understands it.



for large housing contracts, and as such whether multiple housing represents a separate market.

35. The majority of third parties indicated that they believe GDNs/DNOs compete with IGTs/IDNOs. However, three GDNs indicated that they are not competitors for multiple housing installations. Some construction customers indicated that they tend not to use GDNs/DNOs for multiple housing developments, as they are generally more expensive than IGTs/IDNOs and may not meet the demands of developers.
36. The OFT understands that the gas connections market is reasonably well developed, with independent players accounting for a greater proportion of the market than GDNs. In contrast competition in electricity connections is not as developed, with DNOs still accounting for the majority of connections. The Parties and third parties supported this view. DNOs have a larger presence in electricity connections for new developments than GDNs have in gas.
37. Overall, on a cautious basis, the OFT has proceeded to segment the gas and electricity connections markets into (i) installations to multiple housing projects and (ii) all domestic installations (including multiple housing and one-off connections). For the reasons set out above, GDNs and, to some extent, DNOs would account for a comparatively reduced competitive pressure in the multiple housing segments. In the view of the OFT, these are the narrowest plausible segments where competition concerns could arise as a result of the Transaction.
38. Paragraphs 67 to 80 below set out the view of the OFT that no competition concerns arise in the multiple housing segments as a result of the Transaction. As the shares of supply of the Parties are lower in the wider segments of all domestic installations (where GDNs and DNOs are comparatively more active), and there is no evidence to suggest the Parties are closer competitors in this wider supply than they are in relation to the multiple housing segment, the OFT is also of the view that no competition concerns arise in the all domestic segments of either gas or electricity connections.<sup>12</sup>

<sup>12</sup> In addition, the Parties submit that neither GTC nor Inexus was active in the provision of installation services to non-multiple domestic customers, in either the gas or the electricity relevant segments, during 2009, 2010 and 2011.

### **Segmentation by type of connection (domestic/non-domestic)**

39. The Parties submit that in both *United Utilities*<sup>13</sup> and *SP Manweb*,<sup>14</sup> Ofgem noted that there are four broad types of connection:

- industrial and commercial (for example, retail parks and manufacturing plants)
- housing (one-off and multiple developments)
- services/unmetered (for example, street lighting), and
- generation (for example, connecting an electricity generator to a distribution system).

40. The Parties have informed the OFT that the largest connections, which are connected directly to the transmission network, can only be installed by the operator of the transmission network. For all other connections the Parties submit that the same set of competitors exist as for all domestic connections. Additionally, no third party has identified a market for industrial and commercial connections alone.

41. On the basis of this evidence, and taking into account the view of the OFT as set out in paragraph 38 above that the Transaction does not raise competition concerns in any domestic connections segment, the OFT is also of the view that the Transaction does not raise any concern in non-domestic segments.

### **Geographic scope**

42. The Parties submit that the relevant geographic market for both gas and electricity connections, particularly with respect to competition for multiple housing connections, is Great Britain. This is because:

- independent providers including GTC and Inexus have constructed, installed and operated connection assets throughout Great Britain

<sup>13</sup>[www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/55.pdf](http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/55.pdf)

<sup>14</sup>[www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/57.pdf](http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/57.pdf)

- the customers for these services are principally major housing developers which are engaged in housing projects nationally
  - IGTs and IDNOs are licensed to own and operate assets throughout Great Britain; while the local incumbents typically carry out most of the domestic one-off connections within its distribution area, there is Great Britain-wide competition from the major independent providers for connections for housing developments
  - the accreditations an ICP needs from Lloyds Register<sup>15</sup> to install assets are valid across Great Britain. Whilst some (typically smaller) ICPs have a more regional focus, any individual project available for tender to install and/or adopt assets in any part of Great Britain would be expected to attract bids from players situated across Great Britain, and
  - in previous decisions in different markets,<sup>16</sup> without concluding on the point, the OFT has generally taken this approach; Ofgem has referred to the possibility of supply-side substitution leading to a Great Britain-wide (or even UK-wide) market.
43. Large construction customers contacted by the OFT were generally of the view that competition takes place at national or Great Britain level. One developer stated that, 'it is important to have a local service department within the operational region to ensure service provision to sites is maintained, however it is not important to have a main administration office.' Two other developers indicated that the geographic location of the last mile service provider was not at all important. Competitor third parties indicated that the geographic location of the installer was not important. One third party did indicate that 'many are regionally based companies who would find it difficult to work out of their locality due to the travelling time of their labour and machinery. However some operate nationally or across Great Britain, and others outsource their work to local contractors and for these companies location is not so important.'

<sup>15</sup> [www.lr.org](http://www.lr.org)

<sup>16</sup> *E.ON/ABB* (see above footnote 5) and *SSE/Aquila (Anticipated acquisition by SSE Power Distribution Ltd of Aquila Sterling Ltd, OFT, 24 July 2003)*.

44. On the basis of the above considerations, the OFT's view is that it is appropriate to assess the effects of the Transaction on competition at the level of Great Britain.<sup>17</sup>
45. For the sake of completeness, the OFT has also considered whether the competitive analysis might be different in any particular geographic region of Great Britain. As far as narrower geographic frames of reference than Great Britain are concerned, the OFT requested information on the number of competitors present in each region of Great Britain.<sup>18</sup> This data shows that there will remain at least four competitors for any market segment in each of the geographic areas. Ofgem have confirmed that this information is in line with their view of the market.

## **Conclusion**

46. The OFT has analysed the Transaction on the basis of separate markets for the installation and adoption of each of gas and electricity connections separately. The OFT has further segmented the gas and electricity markets into installations to multiple housing projects, as the narrowest plausible segment where concerns may arise.
47. The OFT has analysed the Transaction on the basis of a Great Britain market, although it has also assessed and concluded that there are no regions where the competitive assessment would differ to that for Great Britain as a whole.

## **COUNTERFACTUAL**

### **The OFT's use of counterfactuals**

48. The assessment of the competitive effects of a merger involves a comparison of the prospects for competition with the merger against the

<sup>17</sup> The Parties have informed the OFT that neither GTC nor Inexus are active in Northern Ireland. Therefore, on a cautious basis, OFT has not considered appropriate to assess the effects of the Transaction on an all UK basis.

<sup>18</sup> The parties have been able to provide a list of competitors active in each of the following areas: North and Scotland, North East, Midlands, East, London and Essex, South East, and West. The parties submit that any attempt to estimate regional market shares would be meaningless, as no regional data is available.

competitive situation without the merger. The latter is called the 'counterfactual'.

49. When reviewing a merger, the OFT considers the effect of the merger compared with the most competitive counterfactual providing always that it considers that situation to be realistic. In practice, the OFT generally adopts the prevailing conditions of competition (or the pre-merger situation in the case of completed mergers) as the counterfactual against which to assess the impact of the merger. However, the OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic (for example, because the OFT believes that one of the merger firms would inevitably have exited from the market) or where there is a realistic prospect of a counterfactual that is more competitive than prevailing conditions.<sup>19</sup>
50. The OFT understands that Inexus was historically one of the major independent providers of gas and electricity connections, and a prominent competitor in the provision of such connections for new housing developments. As explained below, Inexus currently has a relatively modest share in the gas and electricity connections markets. However, the OFT has considered whether it would be appropriate to assess the Transaction against a counterfactual in which Inexus would have regained its former competitive strength absent the Transaction (that is, whether there is a realistic prospect of a more competitive counterfactual than prevailing conditions of competition).

### **Inexus's current position in the market**

51. The Parties submit that Inexus has substantially withdrawn from the gas and, to some extent, electricity connections markets in recent years, due in part to a reduction in available financing. The Parties submit that this decision was made in 2009, and entailed implementing a new multi-utility strategy, whereby Inexus targets larger developments and seeks to sell a wider bundle of products (including district heating, electricity, water and fibre connections). [ ]. The Parties have provided internal documentation with regard to Inexus' commercial strategy since 2009, which reflects the move to a multi-utility strategy.

<sup>19</sup> Merger Assessment Guidelines, paragraph 4.3.5.

52. As part of that strategy, Inexus has significantly reduced the number of staff at its Connect brand.<sup>20</sup> Some installation work (particularly in the North of England) has also been outsourced, although Inexus is still responsible for supervising this work through the Envoy subsidiary.<sup>21</sup>
53. The Parties have also submitted information showing a decline in sales of new gas and electricity installations since 2010 by Inexus, which, in the view of the Parties, is a result of Inexus' strategy to stop actively competing to provide such connections (notably gas), although it would still have carried out this work if requested to do so by customers (see paragraphs 55ff below). Some customers of Inexus for gas and electricity connections have indicated that Inexus has been performing poorly in the last twelve months. One customer noted that the limited financial strength of Inexus had led it to choosing an alternative installer in order to minimize contract risks.
54. Therefore, the OFT considers that the evidence available does support the Parties' submission that Inexus has effectively scaled back its activities in gas and, to a lesser extent, electricity installations, to focus on more profitable multi-utility installations, due primarily to a lack of available finance. Inexus' current position in the market is reflected in their relatively small market share for gas installations ([0-10] per cent) and electricity installations ([0-10] per cent) (see in this respect paragraph 66 below on the calculation of meaningful market shares).<sup>22</sup>

**Consideration of whether Inexus refocused on gas and electricity connections is a realistic counterfactual**

55. The Parties accept that, for various commercial reasons, Inexus has not fully withdrawn from gas and electricity connections. In particular, the Parties submit that Inexus' management recognised that stopping gas installation immediately and absolutely would have had a detrimental impact on Inexus' relationships with developers, with whom it contracts to install multi-utility projects. The move to a multi-utility strategy therefore

<sup>20</sup> Connect is Inexus' gas and electricity brand and Metropolitan is its multi-utility brand.

<sup>21</sup> The Envoy brand is an asset management company that does not install or adopt assets.

<sup>22</sup> This figure is based on multiple domestic installations, that is, the narrowest plausible segment where in the view of the OFT competition concerns could conceivably arise as a result of the transaction. See below paragraphs 67 to 80.

needed to be a gradual change. The [ ] was considered in 2010, but in early 2011 it was decided that Connect [ ]. The Parties submit that this was primarily to ensure a cost effective roll-out of the order-book, and to protect Inexus' business reputation.

56. The OFT therefore has considered whether Inexus could have become a stronger competitive constraint going forward than it does at the moment; for instance if it were recapitalised through a sale to an alternative purchaser, if it refinanced its existing debt or if it were to have its debt reduced through an administration process.
57. The Parties submit that such an alternative counterfactual is fanciful, hence the OFT should consider the prevailing conditions of competition as the appropriate counterfactual. The Parties submit that (a) Inexus has currently a highly geared capital structure; (b) Inexus' borrowing costs have significantly increased since 2005 (in particular, between 2005 and 2009 Inexus' weighted cost of borrowing increased from [ ] per cent to [ ] per cent) and (c) a large part of Inexus' debt (up to £[ ] million) was due for repayment on 31 August 2012.<sup>23</sup>
58. The Parties submit that the most likely alternative to Inexus' acquisition by Brookfield is insolvency. Their view is that it is unlikely that another bidder prepared to undertake the necessary recapitalisation would emerge in the absence of the Transaction. The Parties have submitted information about the sale process of Inexus in support of this contention.
59. The Parties also submit that, even in the unlikely event that another bidder prepared to recapitalise did emerge, it is highly unlikely that such a buyer would reduce Inexus' cost of capital such that it would be likely to expand in the gas and electricity connections markets.
60. The OFT has also considered whether Inexus would have been sufficiently relieved of its debt burden by an administration process to substantively re-engage with the gas and electricity installation markets. The Parties submit that whilst the outcome of administration would be uncertain, the most likely outcomes would either be (a) all existing installation activity being

<sup>23</sup> While the OFT was reviewing the Transaction, Inexus debt facilities were extended, on an interim basis, to [ ]. The Parties submit that this short-term extension was predicated upon Brookfield ownership.

wound up, with the creditors seeking to maximise the cashflow from the existing asset base to pay the debt, or (b) if additional investment were to be permitted during a sales process, this would be in line with Inexus' current strategy.

61. The Parties also note that construction companies would be unlikely to want to commit to contracts with a firm in administration, so even if the lenders were willing to sanction additional investment it is not clear that contractors would award contracts to Inexus.

## **Conclusion**

62. On the basis of the above evidence and considerations, the OFT has concluded that any alternative, more competitive, counterfactual under which Inexus re-engages actively in competing for gas and electricity connections is sufficiently uncertain such as not to be appropriately considered as realistic at this point. Hence, the OFT has assessed the Transaction against the prevailing conditions of competition.

## **HORIZONTAL UNILATERAL EFFECT ISSUES**

### **Introduction**

63. The OFT has considered whether, judged against prevailing conditions of competition, the Transactions may lead to unilateral effects in the relevant segments listed above. In doing so, the OFT has looked at concentration as a starting point, and in particular market shares and the number of firms that will remain in the relevant segments following the Transaction. Having looked at concentration, the OFT has then considered closeness of competition between GTC (the relevant Brookfield business) and Inexus, in order to form its view as to whether the Transaction raises unilateral effects concerns.
64. The Parties submit, and the OFT agrees, that competition occurs at the point at which the adopter and/or installer is chosen, and once it has been chosen there is no scope for further competition. In particular, the Parties submit that the adopted and/or installed base of companies is not reflective of their current position in the market (given that it reflects competition in tendering that took place some time ago).



65. The Parties further submit that there is a significant time lag, which can be a number of years, between the point at which there is a tender process to install an asset (that is, the competitive event) and the point at which it is installed. Therefore, even the current installation order book will be reflective of historically competitive events, and as such is not necessarily reflective of the current competitive situation.
66. When considering market shares, the OFT has therefore used market shares estimates based on installation and adoption contracts won at the point in time relevant for the consideration of the Transaction. The Parties have provided such estimates for the three years prior to the Transaction (2009, 2010 and 2011), which are referred to in this section.<sup>24</sup>

#### **Multiple housing installations (gas)**

67. The Parties submit that in 2011 they had a combined market share of [30-40] per cent, with an increment of [0-10] per cent (equal to Inexus' market share), in the segment of multiple housing gas installations. This reduced from a combined market share of [35-45] per cent, with a [five-15] per cent increment, in 2010.
68. As set out above, Inexus' market share for multiple housing gas installations was only [0-10] per cent in 2011. The Parties submit that in 2011 there were at least five companies in the multiple housing gas installations segment with a market share bigger than Inexus', including GTC, as follows:

<sup>24</sup> The parties have estimated market shares on a volume basis (number of plots contracted to be installed/adopted in a given year). The parties submit that they are not able to measure market shares based on revenue because different companies quote different prices for both installation and adoption, and such information is not publicly available.

Company	Market share (new multiple housing gas installation) (per cent)
GTC	[25-35]
BG	[15-25]
UIPs	[15-25]
SSE	[5-15]
Energetics	[5-15]
Fulcrum	[0-10]
Inexus	[0-10]

Source: the Parties

69. Additionally, third parties named numerous other companies active in this segment.
70. As set out in paragraphs 48 to 62 above, Inexus has substantially reduced its activity in the connections market, due primarily to a lack of available finance. Hence, although Inexus may have a large installed base of connections (for which competition occurred at the point of adoption), it can no longer be considered one of the leading suppliers in the market.
71. The OFT has assessed the extent to which, notwithstanding Inexus' relatively modest market share, GTC and Inexus are close competitors. If the products of the merger firms are close substitutes, unilateral effects are more likely because the merged firm will recapture a significant share of the sales lost in response to the price increase, making a price increase less costly.<sup>25</sup>
72. The OFT asked third party house builders who they requested to tender for the installation of gas and electricity connections in their latest housing development. Of three house builders responding to this question: one house builder had requested six installers to tender, including GTC and Inexus;<sup>26</sup> one house builder had requested four installers to tender, including GTC but not Inexus; and one house builder had requested two

<sup>25</sup> Merger Assessment Guidelines, paragraph 5.4.9(a).

<sup>26</sup> This builder indicated that six is the number of installers of gas and electricity connections that they currently use, including Inexus and GTC, therefore the Transaction would represent for their business a 'six to five' reduction in fascia.

suppliers to tender, not including GTC or Inexus. Moreover, as noted above, some house builders noted that Inexus had been performing poorly in the last twelve months.

73. The OFT asked third party competitors in the gas and electricity installations market to provide a list of companies who they believe they compete with. The OFT received responses from seven competitors who, between them, listed at least 15 competing installers.
74. On the basis of this evidence, the OFT does not believe that the Parties are currently close competitors for new contracts, or would be going forward absent the Transaction. Although GTC and Inexus have historically had a high market share, Inexus has won few contracts in recent years and as such would not have significant leverage with contractors.
75. As such, the Transaction is unlikely to eliminate a significant competitive force in the market. Therefore, the OFT does not believe that there is a credible unilateral effects theory of harm in the multiple housing gas installations segment. On this basis, for the reasons explained in paragraph 38 above, the OFT considers that competition concerns can also be ruled out in the all domestic segment of gas installations.

#### **Multiple housing installations (electricity)**

76. The Parties submit that in 2011 they had a combined market share of [25-35] per cent, with an increment of [0-10] per cent (equal to Inexus' market share), in the segment of multiple housing electricity installations. This was slightly reduced from a combined market share of [25-35] per cent, with a [five-15] per cent increment, in 2010. Overall market share estimates in the multiple housing electricity installations segment in 2011 are as follows:

Company	Market share (new multiple housing electricity installation) (per cent)
DNOs	[40-50]
GTC	[20-30]
ICPs	[5-15]
Energetics	[5-15]
Inexus	[0-10]
SSE	[0-10]

Source: the Parties

77. As set out in paragraphs 48 to 62 above, Inexus has substantially reduced its activity in the connections market, due primarily to a lack of available finance. Hence, although Inexus may have a large installed base of connections (for which competition occurred at the point of adoption), it can no longer be considered one of the leading suppliers in the market.
78. Moreover, in contrast to the gas installations market, the electricity installations market is nascent and the DNOs still represent some of the strongest suppliers in the market. All DNOs responding to the OFT's questionnaire indicated that they believed that they are able to compete with the independent operators.
79. As noted in paragraphs 72 and 73 above, the OFT asked third party house builders and third party competitors who they requested to tender for the installation of gas and electricity connections in their latest housing development. The OFT also asked third party competitors in the gas and electricity installations market to provide a list of companies who they believe they compete with. On the basis of the evidence received, the OFT does not believe that the Parties are currently close competitors for new contracts, or would be going forward absent the Transaction.
80. As such, the Transaction is unlikely to eliminate a significant competitive force in the market. Therefore, the OFT does not believe that there is a credible unilateral effects theory of harm in the multiple gas installations segment. On this basis, for the reasons explained in paragraph 38 above, the OFT considers that competition concerns can also be ruled out in the all domestic segment of electricity installations.

### **Adoptions from third parties**

81. The Parties submit that Inexus has not been active in adopting any gas or electricity assets from third party installers since at least 2008.<sup>27</sup> Therefore, there is no overlap in the adoption of assets from third parties.<sup>28</sup>
82. Inexus has arranged for ESP to adopt most of its installed gas connections since [2009].<sup>29</sup> Any effect of the Transaction through the potential withdrawal of Inexus as a source of installed assets requiring adoption is addressed under the vertical effects section below.<sup>30</sup>
83. Therefore, the Transaction does not raise any horizontal unilateral effects concerns in relation to the adoption of either gas or electricity connections from third parties.

### **Potential competition in other utility areas**

84. In addition to their activities in relation to gas and electricity infrastructure, GTC and Inexus have also some activities in other utility areas. In particular, the Parties submit that:
- Inexus competes in providing fibre networks, water connections and district heating connections, and
  - GTC has a small solar business and a small water installation business (without the capability to adopt water connections).
85. The Parties submit that the transaction raises no concerns in other utility areas. The Parties also submit that there is no 'multi-utility market', or none in which the Transaction raises any concerns.

<sup>27</sup> That is, Inexus has not adopted any assets from third parties in 2009, 2010, or 2011. Moreover, Inexus only adopted around [0-five] per cent of its own gas installations.

<sup>28</sup> As stated in paragraph 31 above, the adoption segment considered by the OFT for the purposes of assessing this Transaction refers to adoption services to third party installers. This is on the basis that no competitive event takes place in relation to installations adopted internally.

<sup>29</sup> All Inexus gas installations that have been adopted by a third party have been adopted by ESP.

<sup>30</sup> On the electricity side, Inexus has not required any third party to adopt its installed connections in 2011, 2010 and 2009, since all the electricity connections installed by Inexus over that period were adopted internally.

86. In relation to water connections, both Inexus and GTC are capable of installing water connections, but whilst Inexus has been appointed by Ofwat as a water and sewerage undertaker, GTC has not, limiting GTC's water capability to installation only. Therefore the Parties overlap in the provision of water installation services.<sup>31</sup> The Parties submit that GTC's market share in water installations would be less than [0-five] per cent, and Inexus' market share in water installations would be less than [0-five] per cent. A number of third party competitors in gas and electricity noted that they also compete in water connections.<sup>32</sup> On the basis of the small market share of the Parties in water installations, the OFT believes that there are no plausible competition concerns in water.
87. In relation to fibre, whilst Inexus offers a fibre connection product,<sup>33</sup> GTC does not offer any product in this area. GTC has considered market entry in this area. However, the OFT understands that [ ] any entry into the segment would involve the same steps as a new entrant. The OFT therefore believes that no competition concerns arise from the Transaction in relation to fibre connections, as the Parties do not currently overlap in any fibre activities, and the Transaction is unlikely to lessen competition by removing a significant competitive constraint arising from a potential entrant to the market.
88. In relation to district heating,<sup>34</sup> the Parties submit that Inexus has won a significant project involving district heating at King's Cross and has [ ] more projects either at preferred bidder or heads of terms stages, but GTC does not have any district heating activities. The OFT believes that no competition concerns arise from the Transaction in relation to district heating, as the Parties do not currently overlap in any district heating activities.

<sup>31</sup> For similar reasons to those explained in relation to gas and electricity, on a cautious basis the OFT considers appropriate to assess whether competition concerns arise within the installation segment for water, as a segment different from adoption.

<sup>32</sup> However, both the Parties and third party competitors indicated that water has seen little deregulation and incumbent water companies are the main players in the market.

<sup>33</sup> This is a so called 'fibre to home' offering, which the OFT understands is a form of 'last mile' telecommunications connection. The Parties submit that the offering competes with other types of telecommunications connections different from fibre.

<sup>34</sup> District heating is the operation of on-site energy sources (for example, at combined heat and power (**CHP**) stations, which are used to provide heating to a district of homes, rather than the homes having individual heating sources.

89. In relation to solar panels, the Parties submit that GTC has developed a solar panel product, but Inexus does not have a full engineering accreditation in the installation of such product; therefore the Parties do not overlap in solar panel activities. Whilst GTC used to offer a different solar panel product, the Parties submit that GTC no longer markets such product, due to the reduced availability of public funding for solar power. The OFT believes that no competition concerns arise from the Transaction in relation to solar panels, as the Parties do not currently overlap in any solar panel activities.

## Conclusion

90. On the basis of the above considerations and the information presented to it, the OFT believes that the Transaction does not raise competition concerns in relation to other utility areas. Nor does the OFT consider that the Transaction raises concerns in relation to the supply of multi-utility connections.

## Barriers to entry and expansion

91. Any analysis of a possible substantial lessening of competition includes consideration of the responses of others (for example, rivals, potential rivals and customers) to the Transaction. In the longer term competition in the market may also be affected as new firms enter, or the merged firm's rivals take actions enhancing their ability to compete against the merged firm.<sup>35</sup>

92. As explained above, GTC and Inexus overlap in the gas and electricity multiple housing installation segments. These are the narrowest plausible segments where competition concerns may arise as a result of the Transaction.

<sup>35</sup> Merger Assessment Guidelines, paragraph 5.8.1.

93. The Parties submit that barriers to entry in gas and electricity installation segments are very low, and that this is not a regulated activity, so does not require a licence from Ofgem. The Parties submit that a potential UIP would need to:

- assemble a team of workers, including a leader with credibility that developers will be comfortable instructing
- obtain partial accreditation from Lloyds Gas Industry Regulation Scheme (**GIRS**), and
- win a tender and complete the build to complete the full GIRS accreditation, which would then enable the UIP to complete work on future projects.

94. The Parties have also provided examples of at least two new entrants into the gas and electricity installation segments ([ ]), of whose entry the Parties became aware as recently as September and November 2011. One of these new entrants ([ ]) has indicated to the OFT that they generated turnover of in excess of £[ ] in their first year, and that [ ]. [ ] indicated that they spent around £[ ] to enter the market.

95. On the basis of this evidence, the OFT does not believe that barriers to entry are insurmountable. However, given the competition assessment above, the OFT has not found it necessary to conclude on whether barriers to entry and expansion are present on the market.

### **Buyer power**

96. The OFT has also considered whether customers would have countervailing buyer power. In some circumstances, an individual customer may be able to use its negotiating strength to limit the ability of a merged firm to raise prices. This is referred to as countervailing buyer power.<sup>36</sup>

97. The Parties submit that customers, particularly for gas installations are typically the large UK housing developers, and as such they have significant buyer power and utilise competitive tendering processes. Large

<sup>36</sup> Merger Assessment Guidelines, paragraph 5.9.1.



house builder customers contacted by the OFT in relation to the Transaction tended to agree with the Parties assessment.

98. The OFT notes that since contracts are individually negotiated there is no clear mechanism by which buyer power for large customers would help to shield smaller customers from any anticompetitive effect. However, given the competition assessment above, the OFT has not found it necessary to conclude on buyer power.

## **VERTICAL ISSUES**

99. The OFT has considered whether the Transaction could raise competition concerns on the basis of vertical effects.
100. GTC is active in the 'upstream' supply of adoption services to third parties in gas and electricity. In turn, Inexus has arranged for ESP, a competitor of GTC, to adopt most of its installed gas connections since [2009].<sup>37</sup> <sup>38</sup>As part of the assessment of vertical effects, the OFT has therefore considered whether, by removing Inexus as an independent customer from the third party gas adoptions segment, the Transaction could lead to competitor foreclosure in that segment.
101. According to the estimates provided by the Parties for 2011, Inexus is the receiver of [five-15] per cent of all adoption services supplied in the gas segment. According to the same estimates, adoption services were supplied to various installers in this segment, of which BG received the largest share of supply ([45-55] per cent), Inexus the second largest share ([five-15] per cent) and a variety of UIPs received the remainder of adoption services ([35-45] per cent). The biggest suppliers of gas adoption services to third party installers according to the Parties' estimates are GTC ([40-50] per cent) and ESP ([40-50] per cent).
102. On the basis of the above estimates, the OFT does not believe that there is a credible vertical theory of harm arising from the Transaction in relation to gas adoptions. Even if Inexus were to stop requiring any gas adoption services from third parties following the Transaction, demand for adoption

<sup>37</sup> All Inexus gas installations that have been adopted by a third party have been adopted by ESP.

<sup>38</sup> As indicated in footnote 30 above, on the electricity side, Inexus has not required any third party to adopt its installed connections in 2011, 2010 and 2009, since all the electricity connections installed by Inexus over that period were adopted internally.

services is likely to continue to come from a variety of installers, which are not integrated with an adopter.

### **THIRD PARTY VIEWS**

103. The OFT has received representations from four competitors of the Parties expressing concerns about the impact of the Transaction. These concerns are addressed in this section.
104. One competitor noted that regulatory work to create fully competitive markets in electricity and water connections had not yet been completed. This competitor also noted that 'a merger of the two largest independent organisations this early in the evolution of the market may undermine those efforts.' Another competitor said that by removing one independent connections provider from the market, the independent connections market might be 'on the verge of monopoly situation'. A further competitor stated that the Transaction is 'contrary to the interests of free and fair competition', without providing any relevant evidence to substantiate this claim.
105. As set out in this decision, the OFT believes that, although GTC and Inexus have historically had a high market share, and have a relatively high share in terms of installed base, the Transaction does not eliminate a significant competitive force in the market due in particular to the limited financial strength of Inexus and its relatively small current market share in terms of installation activity. The OFT believes that certain of the comments received by third party competitors are based on Inexus' historic market position, rather than reflecting Inexus' current competitive situation.
106. One competitor raised concerns that the Parties could, following the Transaction, use their combined position to apply pressure to ensure that contractors discriminate against other independent installers or adopters. However, the OFT has seen no evidence to support the theory that the Parties would have the ability or the incentive to engage in such behaviour, and this concern was not raised or corroborated by any other third parties.
107. None of the customers of the Parties contacted by the OFT, including developers, raised concerns about the effects of the Transaction. As noted in paragraph 53 above, some third party customers have drawn attention to Inexus' declining strength and performance. In view of this, one housing

developer expressed its wish for GTCs operating standards to be rolled out across Inexus following the Transaction.

108. The OFT discussed its assessment of the Transaction with Ofgem, the competition authority (responsible under the Competition Act 1998 for enforcing competition law in the gas and electricity sectors) and sectoral regulator for the gas and electricity markets. Whilst recognising that merger decisions are ultimately a matter for the OFT, based on their understanding of the Transaction, Ofgem did not have any reason to doubt the evidence put forward that any competition concerns arising from the Transaction would be likely to be mitigated by the relatively low barriers to entry in this market and the threat of new entry or expansion by existing competitors. Ofgem also noted the Parties' submission that Inexus was largely withdrawing from the market for the provision and operation of gas and electricity connections to housing developments in order to focus on 'multi-utility' projects.

## **ASSESSMENT**

109. The Transaction qualifies for review on the basis of the share of supply test given that the Parties will have a combined share of supply of around [30-40] per cent of gas installations to new build housing developments in the UK.
110. The OFT has analysed the Transaction on the basis of separate markets for the installation and adoption of both gas and electricity connections. The OFT has further segmented the gas and electricity markets into installations to multiple housing projects, as the narrowest plausible segment where concerns may arise.
111. The OFT has analysed the Transaction on the basis of a Great Britain market, although it has also checked and concluded that there are no regions for which the Transaction would result in a different conclusion to the competitive analysis applicable to Great Britain as a whole.
112. The OFT has assessed the Transaction against the prevailing conditions of competition. The OFT has concluded that any alternative, more competitive, counterfactual (under which Inexus would re-engage actively to compete more strongly in the gas and electricity connection markets

absent the Transaction) is sufficiently uncertain so as not to be considered realistic.

113. Based on their market shares in the gas and electricity installation segments and the number of existing competitors in the market, the Transaction does not create prima facie horizontal competition concerns. In addition, the OFT does not believe that the Parties are currently close competitors and considers that the Transaction is unlikely to eliminate a significant competitive force in the market. In particular, the OFT believes that Inexus has effectively scaled back its activities in gas and electricity installations, to focus on more profitable multi-utility installations, due primarily to a lack of available finance.
114. The OFT does not believe that there is a credible vertical theory of harm arising from the Transaction in relation to gas adoption, as demand for adoption services is likely to continue to come from a variety of installers, which are not integrated with an adopter.
115. Consequently, the OFT does not believe that it is or may be the case that the Transaction has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

116. This merger will therefore **not be referred** to the Competition Commission under section 22 of the Act.