OFFICE OF FAIR TRADING

Anticipated acquisition by John Wood Group plc of Production Services Network Limited

ME/4815/10

The OFT's decision on reference under section 33(1) given on 4 March 2011. Full text of decision published 17 March 2011.

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. **John Wood Group plc (Wood Group)** is listed on the London Stock Exchange and is a leading international energy services company comprised of three divisions: Engineering & Production Facilities, Well Support, and Gas Turbine Services. Wood Group is a provider of subsea and pipeline engineering, supply and repair of well-head equipment, and the repair and overhaul of gas turbines and other rotating equipment. It currently employs 29,000 people in 50 countries and has global turnover of approximately US$5 billion.

2. **Production Services Network Limited (PSN)** was established in 2006 and is active in the provision of long-term support for customers who operate existing oil & gas facilities. Its services in the UK comprise studies, engineering and construction (E&C), and operations and maintenance (O&M). PSN employs over 8,500 people across more than 20 countries and has global turnover of over US$1.2 billion. PSN's UK revenue was [ ] in 2009.

TRANSACTION

3. Wood Group proposes to acquire the entire issued and to be issued share capital of PSN. The parties notified the transaction to the Office of Fair Trading (OFT) on 10 January 2011. The OFT's administrative deadline for

deciding whether to refer the merger to the Competition Commission (CC) is 4 March 2011.

JURISDICTION

4. As a result of this transaction Wood Group and PSN will cease to be distinct. The UK turnover of PSN exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

5. The parties' activities overlap in three principal areas, Engineering and Construction (E&C), Operations and Maintenance (O&M) and Studies, which are all services offered to the oil and gas industry, whether on offshore oil and gas production and storage facilities, or at onshore oil and gas reception terminals.

Product scope

6. The parties argued that there is limited substitution between these areas of overlap. Even when supplied to the same facility, they are typically subject to separate tender, although some facility owners may, for convenience, choose to have combined (integrated services) contracts for the provisions of these types of services. In addition, the parties argued that there is some, but limited, scope of substituting the resources used for the supply of one category to supply another. There are some overlaps in terms of the skills and resources used to supply each of these services, in particular in relation to scaffolders, painters and riggers who are required for both E&C and O&M work. However, the parties stated that the more conservative approach is to treat each of them as a separate market.

7. The OFT received mixed views from third parties on whether O&M and E&C should be treated separately or jointly.

E&C

8. E&C covers a broad spectrum of work which ranges in terms of the level of conceptual work, detailed design, engineering capacity, construction

resources and costs involved. The parties argued that there are two types of E&C contracts. In particular, there is general (day to day) work typically conducted pursuant to a contract of between two and five years in duration and which covers minor modifications and small projects needed by the operator in question on the facilities covered by the contract. In addition, there is project work, which consists of larger ad hoc pieces of work, which the operator will generally tender for specifically either during the life of the facility or for its decommissioning. The parties argued that there is no consistent distinction between the two as the size of the work that is tendered for will vary by operator and will also depend on the general E&C contract which is in place at the relevant time.

9. The parties stated that general E&C work will range in value from small jobs of £50,000 or less to large work, typically up to £10 million but sometimes up to £50 million per annum in value. Project work can in turn be broadly divided between work of under and over £250 million in value.[1]

10. In addition, the parties argued that there is no distinction in terms of the skills/manpower needed to service an E&C contract for offshore oil and gas production and storage facilities compared to such a contract for an onshore reception terminal. The parties believe it is not therefore appropriate to sub-segment the market further and third party responses did not suggest this was appropriate.

O&M

11. O&M involves the provision of ongoing support services for the operation and maintenance of existing oil and gas facilities and onshore reception terminals. A full service O&M contract will typically comprise full or partial provision of the office-based management of the associated on-site maintenance activity and operation of the facilities and maintenance of the on-site equipment and machinery. In addition, suppliers of O&M can be broadly characterised as 'Tier 1' or 'Tier 2', where Tier 1 providers will perform the management/supervision role and offer a broadly comprehensive O&M service including project and contract management, notwithstanding that some of the work may in fact be outsourced to Tier 2 companies. Tier 2 providers will typically offer niche products which fulfill

[1] [ ].

only a specific range of the operator's needs. Tier 2 providers may contract directly with the operators or be engaged through Tier 1 providers.

Studies

12. 'Studies' are predominantly desk-based consultancy services which are provided at the preliminary phases of larger (non routine) E&C contracts and Projects work. Studies work involves preliminary engineering and economic feasibility studies, site identification and evaluation, hazard identification and operability studies, cost estimates and schedule development on a particular project contemplated by an oil and gas operator. The Studies market is distinct from the aspects of the provision of services to the oil and gas industry and there is limited substitution between studies and E&C services.

13. In 2009 Studies accounted for [ ] of Wood Group's and [ ] of PSN's UK turnover. Due to the lack of any third party comments or concerns in this area and the minimal increment arising as a result of the merger the OFT concluded that Studies will not be analysed any further in the competitive assessment of the merger.

Conclusion

14. Therefore, based on the evidence before it, the OFT believes that E&C and O&M form separate markets. However, on a cautious approach and without prejudice to the precise market definition, the OFT assessed the impact of the merger on E&C and O&M taken together as well as separately.

Geographic scope

15. The parties argued that the narrowest hypothetical geographic market is the UK Continental Shelf (UKCS). The parties stated that as a result of strong competition there are only limited examples in recent years of providers from outside the region commencing activity in the UKCS.

16. The parties stated that incumbent UKCS providers are constrained by the possibility of competition from outside. In particular, there are no regulatory impediments to entry to the UKCS market from the Norwegian North Sea. One competitor stated that entry to the UKCS can and does happen from

suppliers who have originated in the Norwegian North Sea. Similarly, there are no barriers to entry in terms of capital expenditure or availability of resources in relation to entry into the Norwegian North Sea by suppliers of E&C and O&M services in the UKCS. Third parties have not raised any barriers (other than a local office and reputation, as well as local variations in competition) that would prevent local movement.

17. Geographic expansion by (E&C) companies active in other areas is feasible according to the parties within a short timeframe as the resources needed are readily available. Third parties tended to agree that firms could if willing set up operations quickly, but it was not clear the extent of intention and capability of potential entrants. Competition from other areas has in particular been seen with respect to the largest E&C contracts.

18. Finally third parties tended to believe that a UK operation and base in Aberdeen was required for providing services in the UKCS.

19. Therefore, based on the evidence before it, the OFT concluded that the relevant geographic scope is the UKCS and assessed the impact of the merger on this basis.

UNILATERAL EFFECTS

Introduction

20. As stated in the Mergers Assessment Guidelines, '[t]heories of harm are drawn by the Authorities to provide a framework for assessing the effects of a merger and whether it would lead to a substantial lessening of competition. They describe possible changes arising from the merger, any impact on rivalry and expected harm to customers as compared with the situation likely to arise without the merger'.[2]

21. Before setting out its theories of harm in relation to this investigation, the OFT has summarised the share of supply information provided by the parties by reference to E&C and O&M services.

[2] OFT/CC Mergers Assessment Guidelines, paragraph 4.2 (OFT 1254).

Share of supply

22. The parties provided data with market share estimates for the supply of E&C and O&M services in the UKCS. In particular, for a market comprising both E&C and O&M services in the UKCS the parties' combined market share will be [40-50] per cent with an increment of [10-20] per cent, followed by Petrofac with [20-30] per cent, Amec with [10-20] per cent and Aker with approximately [zero-10] per cent.

23. For the provision of E&C contracts and projects in the UKCS the parties' combined market share is [40-50] per cent with an increment of [10-20] per cent, whilst Petrofac has [zero-10] per cent, Aker has approximately [0-10] per cent and Amec has approximately [10-20] per cent.[3] In this respect, the parties argued that their combined market share is overstated as in-house supply has been excluded and there will be some E&C work which is undertaken in-house. In addition, the parties estimated that their combined market share for the provision of E&C work for projects less than £50 million in the UKCS was [40-50] per cent with an increment of [20-30] per cent, while Petrofac has [10-20] per cent, Amec has [10-20] per cent and Aker has [zero-10] per cent.

24. For the provision of O&M services in the UKCS the parties provided market share estimates showing that the merged entity will have [40-50] per cent with an increment of approximately [10-20] per cent, while Petrofac has [30-40] per cent, Amec has [10-20] per cent and Aker has approximately [zero-10] per cent. The parties argued that these estimates are overstated as in-house supply has been excluded and argued that there was significant in-house supply of O&M services in the UKCS, with [ ] alone providing around [ ] of O&M services per year and Wood Group estimating that total in-house O&M supply in the UKCS is worth around [£200-300] million per year. Therefore, the parties argued that, if this were included in the market share estimates provided, the merged entity's market share would be approximately [30-40] per cent.

25. The above shares of supply may be indicative of competition concerns and the OFT has therefore examined below the closeness of competition between the parties and whether there are other actual or potential suppliers that are capable of constraining the merged entity.

[3] The data provided by the parties excluded projects over £250 million [ ].

Closeness of Competition

26. The parties provided some data on bids submitted by the main firms in the industry. In this data, the parties listed where they knew at least one competitor, Wood Group submitted bids for [30-40] contracts and PSN for [30-40] contracts. In addition, the data showed that Aker submitted bids for at least [10-20] contracts, Amec for at least [20-30] contracts, Petrofac for at least [20-30] contracts and other competitors submitted bids for at least [10-20] contracts.

27. The parties noted that it was inherent in the database they provided that they will be present in bids more often than their competitors and they believed that the data showing competitors' market shares was not indicative of their competitive strength. The parties claimed that even when the bidding data showed that it was unknown whether a firm had bid for a particular contract, it may well have bid, been approached, or provided some other competitive constraint (for example, an expectation of a bid). In addition, the parties listed the winner as unknown in a large number of contracts. In particular for the [50-60] bids that Wood Group bid for, Wood Group only won [zero-10] contracts, PSN won [zero-10] contracts, and the other [30-40] ([60-70] per cent) of contracts were awarded to other unidentified firms.

28. From the third party responses that the OFT received, no-one argued that the merging parties were each other's closest competitors overall. Only one third party stated that the parties were each other's closest competitors for E&C framework contracts and smaller projects (less than £50 million) and argued that the merged entity will have a market share of approximately 40 per cent.

29. Based on the evidence before it, the OFT believes that the data provided by the parties on bids they have submitted provides some evidence to suggest they are not each other's closest competitor (considering the large number of contracts won by 'others') but it is not conclusive. The OFT is of the view that it is likely that the parties have been at least exerting some competitive constraint to each other for a number of bids and in particular for E&C projects of less than £50 million. Therefore, the OFT assessed the competitive constraint that other firms are capable of exerting.

Alternative suppliers

30. The parties argued that they faced competition from a number of suppliers currently active in the UKCS. In particular, they stated that Aker, Amec and Petrofac were supplying each of the major E&C and O&M services in the UKCS and that there was nothing to prevent customers from switching away from the merged entity to one of these other suppliers. This view was confirmed by the majority of customers that the OFT contacted. In particular, customers considered Aker, Amec and Petrofac to be equal alternative suppliers to the parties for the provision of E&C and O&M services in the UKCS and stated that there would be sufficient competition in the market post-merger. In addition, five customers were supportive of the merger.

31. However, one customer stated that for E&C projects of less than £50 million in value, the parties were the only viable suppliers with a presence in Aberdeen, which was necessary in order to manage these projects. In particular, the same third party stated that other suppliers did not have engineering expertise in Aberdeen to support a large number of contracts and the merger would result in a reduction of realistic available suppliers from two to one. However, further third party responses confirmed that Amec, Aker and Petrofac had an Aberdeen base and were considered by the majority of customers as viable alternatives for all E&C and O&M contracts.

32. In addition, the parties argued that smaller competitors, like Salamis, Altra/OGN could easily expand their current offer, as there were no capacity constraints or other obstacles preventing competitors from increasing their share of UKCS supply of E&C and O&M services. In addition, the parties argued that geographic expansion by companies active in other areas (Aibel or Fabricom from Norway, Stork or Jacobs active in the Netherlands and Worley Parsons from Australia) is feasible within a short timeframe as the resources needed are readily available. Furthermore, the parties stated that the costs associated with such expansion are low (typically only management systems, adaptation to local regulations and initial recruitment of local expertise).

33. As regards manpower involved in fulfilling an additional E&C or O&M contract, the parties argued that it was not necessarily the case that

additional staff will be needed. Indeed, when such staff is required, it is typically the case that they are inherited from the incumbent via a TUPE[4] transfer. In addition, the parties stated that it is possible to outsource staff from specialist manpower providers such as Brunel, Fircroft and Orion, as well as to employ ad hoc skilled workers on temporary contracts who readily switch suppliers. In this respect a number of competitors confirmed that there were no capacity constraints and that they viewed themselves as viable for all contracts. In addition, a number of customers stated that smaller suppliers, like Fabricom and Worley Parsons were capable of providing E&C and O&M services in the UKCS. Finally third parties stated that they have used consortia in several projects.

34. The parties stated that operators have the ability to self-supply E&C and O&M services. In particular, the parties provided examples showing that firms, like Centrica, Maersk and Marathon, have sourced much of the E&C and O&M service in-house. In this respect, third party views were mixed, where a number of customers stated that they considered self-supply as a viable alternative (particularly for O&M), while other customers were negative on the possibilities for an in-house service.

35. Finally, the OFT received evidence of significant buyer power in the case of many of the contracts. Third parties stated that they design sophisticated bidding processes and have a detailed knowledge of the suppliers' margins (which appeared low). In addition, the parties' internal documents supported the view that buyer power was strong and would remain so post merger.

36. Based on the evidence before it and the large number of positive third party responses, the OFT believes that there are alternative competitors capable of restricting the parties post-merger. In particular, the OFT understands that there are at least three other strong players, Amec, Aker and Petrofac in the provision of E&C and O&M services in the UKCS. In addition, based on the evidence available to it, the OFT believes that smaller firms are capable of expanding their current offer. Therefore, the OFT concludes that there is no realistic prospect of a substantial lessening of competition in the provision of E&C and O&M services in the UKCS.

[4] The Transfer of Undertakings (Protection of Employment) Regulations 2006.

THIRD PARTY VIEWS

37. The OFT received a number of comments from third parties, including competitors and customers. These have been dealt with above where relevant.

38. The majority of third parties did not raise any competition concerns as a result of the merger. In particular, 20 customers stated that there were a number of alternative suppliers to the parties and that there was enough competition in the market.

39. One customer raised some competition concerns in relation to the supply of E&C contracts of less than £50 million in value. In particular, this customer stated that the parties were the only realistic suppliers for such contracts with the necessary engineering expertise in Aberdeen. These concerns have been dealt with above.

ASSESSMENT

40. The parties overlap in the supply of E&C and O&M services in the UKCS. The OFT assessed the impact of the merger on the E&C and O&M market in the UKCS as a whole as well as separately.

41. In particular, for a market comprising both E&C and O&M services in the UKCS the parties' combined market share will be [40-50] per cent with an increment of [10-20] per cent, followed by Petrofac with [20-30] per cent, Amec with [10-20] per cent and Aker with approximately [zero-10] per cent. For the provision of E&C contracts and projects in the UKCS the parties' combined market share is [30-40] per cent with an increment of approximately [10-20] per cent, whilst Petrofac has [zero-10] per cent, Aker has approximately [zero-10] per cent and Amec has approximately [10-20] per cent. Finally, for the provision of O&M services in the UKCS the parties provided market share estimates showing that the merged entity will have [40-50] per cent with an increment of approximately [10-20] per cent, while Petrofac has [30-40] per cent, Amec has [zero-10] per cent and Aker has approximately [zero-10] per cent.

42. Notwithstanding the relatively high market shares of the parties and the evidence showing that it is likely that the parties have been at least exerting some competitive constraint to each other for a number of bids and in particular for E&C projects of less than £50 million., the OFT's market investigation revealed that there were at least three alternative suppliers of E&C and O&M services, that competed with the parties and that customers were willing to switch to in case the merged entity raised its prices or reduced the quality of its services. The parties' bidding information, while not conclusive, did suggest that there were a number of alternative bidders and, indeed, that 'Others' won a large proportion ([60-70] per cent) of contracts the parties bid for. In addition, further evidence indicated that smaller players were considered as possible alternatives to the parties by most customers and could expand their current offer and other firms active in other geographic areas could enter the UK market. Finally, evidence available to the OFT showed that some operators sourced much of the E&C and O&M service in-house.

43. The large majority of customers and competitors did not raise any competition concerns and some third parties were supportive of it.

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

DECISION

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

ENDNOTE

1. In paragraphs 23 and 24 the parties clarified that their combined market shares for the provision of E&C contracts and the provision of O&M services in the UKCS were overstated because of the relative visibility of their own versus third parties' sales.