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## Anticipated acquisition by Carillion plc of Mowlem plc.

The OFT's Decision on reference under section 33 given on 24 January 2005.  
Full text published 6 February 2005.

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Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' request for reasons of commercial confidentiality.

### PARTIES

1. **Carillion plc** (Carillion) is a provider of construction and various building-related maintenance and facilities management (FM) services. It is active in a wide range of areas within the UK including the construction and FM of commercial buildings, hospitals, and road and rail infrastructure. It also provides FM services related to mechanical and electrical maintenance. Carillion's UK turnover for the year ending 31 December 2004 was approximately £1,600 million.
2. **Mowlem plc** (Mowlem) is a provider of construction, FM and civil engineering services. Mowlem's construction and FM activities include commercial buildings, rail and road infrastructure, water and other utilities, and government owned buildings. Mowlem also provides a number of individual FM services such as mechanical and electrical maintenance, cleaning and security. For the year ending 31 December 2004, Mowlem's UK turnover was £1,538 million.
3. Mowlem's subsidiary, Edgar Allen Limited (Edgar Allen), supplies track components to the rail construction industry. Carillion has announced that if its merger with Mowlem is successfully completed, Balfour Beatty plc, a competing construction firm, will acquire Edgar Allen from Carillion.<sup>1,2</sup>

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<sup>1</sup> Balfour Beatty plc has agreed to acquire two Mowlem businesses, Edgar Allen and Charter, a construction management company. The announcement was made on 18 January. See <http://www.companyannouncements.net/cgi-bin/articles/200601181604041266X.html>

<sup>2</sup> Any acquisition of Edgar Allen by Balfour Beatty plc would constitute a separate transaction from the acquisition by Carillion of Mowlem. The OFT does not consider that the agreement makes Carillion and Balfour Beatty plc associated persons under section 127 of the Enterprise Act 2002.

## **TRANSACTION**

4. The proposed merger is a recommended public offer for the whole of the issued and to be issued share capital of Mowlem, to be paid for in cash and Carillion shares. Based on values at the time the parties' announced the proposed merger, the transaction is worth approximately £313 million.<sup>3</sup> The merger is expected to be completed in March 2006, although it is conditional upon being cleared by competition authorities.<sup>4</sup>
5. The statutory deadline for consideration of this transaction expired on 24 January.

## **JURISDICTION**

6. As a result of this transaction Carillion and Mowlem will cease to be distinct enterprises. As the turnover of Mowlem is greater than £70 million, the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. It does not meet the thresholds for notification under the EC Merger Regulation. The OFT therefore considers 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.

## **RELEVANT MARKET**

7. The parties overlap in the provision of construction and FM services. These two areas are discussed, in turn, below.

### **Product market (construction)**

8. The OFT has considered whether it is appropriate to segment construction activities into the following sub-divisions:
  - a. categories of work, comprising housing (private and public), new building, repair, maintenance and improvement (RMI) and infrastructure;
  - b. different industry sectors (e.g. education, health, defence, office and retail); and
  - c. bands according to contract size.
9. The parties, as well as other construction firms, told the OFT that because the skills and resources required for construction are reasonably generic, supply side substitution is easy and therefore it is not appropriate to segment construction

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<sup>3</sup> The proposed merger was announced on 14 December 2005.

<sup>4</sup> It has also been notified in the US and the Republic of Ireland.

according to categories of work or industry sectors. One construction firm told the OFT that it moved into the construction of private housing within a year.

10. However, another construction firm submitted to the OFT that while switching between categories of work or between industry sectors was overall not that difficult, in some instances there would be some specialist skills and/or experience required (e.g. obtaining planning approval for large new house building projects) before a firm could switch quickly and successfully. The OFT has been told that a proven track record may also be important in winning new build contracts (and less so for winning RMI contracts) which may suggest that supply side switching may only be effective in the longer term in some instances.
11. However, for the purpose of this proposed merger it is not necessary to conclude on whether the frame of reference is construction as a whole or whether it should be sub-divided into categories of work or industry sectors. The OFT has considered the impact of the merger using all of these definitions.
12. The parties argued that segmenting construction into contract sizes was not appropriate. Larger construction firms compete for contracts of all sizes (e.g. between 1999 and 2003, almost [ ] of the contracts Mowlem won were worth £10 million or less and almost [ ] were worth £5 million or less).
13. In addition, while some balance sheet strength is usually required when bidding for contracts which may exclude some firms from making solo bids for larger contracts, the OFT has been told that it is common for firms to form consortia when bidding for large contracts. As such, smaller firms are not excluded from being a part of a winning bid for larger contracts.
14. For the purpose of assessing the proposed merger, the OFT has not differentiated between construction contracts of different sizes.

#### **Geographic market (construction)**

15. The parties submitted to the OFT that the appropriate geographic scope for construction was the whole of the UK. However, the parties, other construction firms and customers all told the OFT that in some cases it was common for firms outside of the UK to bid for (and win) contracts (although often as part of a wider consortium).
16. However, most in the industry who contacted the OFT (whether construction firms or customers) said that some presence in the UK was often necessary or at least advantageous. For the purpose of this merger assessment the geographic scope has been taken by the OFT to be the whole of the UK.

### **Product market (facilities management)**

17. FM covers a broad range of activities from cleaning services, security services to the operation of some technical installation. FM contracts can be for one or two specific services, or they can be to provide all the facilities-related services (known as total facilities management (TFM)).
18. The parties considered that FM services should be considered as a single product market rather than segmenting them into individual types of services. No third party provided evidence or arguments to the OFT that FM services should be segmented.
19. The OFT has been told by the parties as well as from some third parties that in general the requirements of providing core FM services are very much the same across industry sectors. However, there are some specialist FM services (described to the OFT as 'peripheral') which require some knowledge of the industry sector in order to win a FM contract in it.
20. Given the lack of competition concerns in this case, it was not necessary to conclude on whether the appropriate frame of reference should be specific industry sectors although these were considered by the OFT in its analysis.

### **Geographic market (facilities management)**

21. The parties submitted that the appropriate geographic frame of reference was the whole of the UK. The parties themselves and other large providers are able to tender for contracts in any part of the UK.
22. Third party responses to the OFT indicate that the whole of the UK seems to be the appropriate frame of reference. Some customers told the OFT that they required a UK presence, and some even said a presence nearby their facility was required, but across the range of customers who responded a presence in any region was not particularly important to customers.
23. For the purpose of this merger assessment the OFT has taken the FM geographic frame of reference to be the whole of the UK.

## **HORIZONTAL ISSUES (CONSTRUCTION)**

### **Market shares**

24. The Department of Trade and Industry (DTI) has estimated that the UK construction sector was worth £102.3 billion in 2004.<sup>5</sup> Based on this, the parties' combined share of supply was around [1-5] per cent (increment of [<1] per cent). Another way to measure share of supply is based on shares of contract values won. On this measure the parties' combined share was [1-5] per cent (increment [1-3] per cent) in 2005 ([5-10] per cent, increment of [1-3] per cent, in 2004).
25. When analysed by type of work, in 2004 the parties' combined share of supply ranged from around [1-5] per cent (private new house build), to [10-20] per cent (railways).<sup>6</sup> However, for construction services for railways, the merged party will still be the second largest supplier after Balfour Beatty. For RMI and new builds the parties' combined share of supply was also small ([1-5] per cent and [1-5] per cent respectively).
26. By industry sector, the parties had a combined share of supply in 2004 of a similarly small level - ranging from [1-5] per cent (office, leisure and industrial sectors) to [1-5] per cent for the defence sector.<sup>7</sup>

### **Barriers to entry and expansion**

27. The OFT has been told that barriers to entry to construction are quite low. Much of the work is subcontracted, much of the plant and machinery is hired or leased and it is common for some payments to be made in advance.
28. Carillion and Mowlem submitted to the OFT that the number of UK construction firms increased by over 40 per cent between 1999 and 2003. The average size of construction firms (in terms of employees) also increased (which they said indicated low barriers to expansion).
29. The parties have told the OFT that recruiting suitably skilled and experience staff, as well as building up a network of proficient subcontractors can be difficult. In addition, third parties said that for larger, more complex contracts a proven track record is often required. A third party construction firm told the OFT that this could take up to seven years to build up.

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<sup>5</sup> DTI construction statistics - <http://www.dti.gov.uk/construction/stats/021205/3.xls>.

<sup>6</sup> Railways is classified as a sub-category of infrastructure work for which the parties had a combined share of [10-20] per cent.

<sup>7</sup> Based on new build, RMI and infrastructure work.

30. However, given the lack of competition concerns based on the structure of the industry it is not necessary for the OFT to conclude on the strength of barriers to entry and expansion.

#### **Buyer power**

31. Large construction customers have told the OFT that they are not concerned about the merger because of the competition and choice that exists in the industry. Given the lack of competition concerns it is not necessary for the OFT to reach a conclusion on countervailing buyer power.

### **HORIZONTAL ISSUES (FACILITIES MANAGEMENT)**

#### **Market shares**

32. Estimates for the size of the FM industry in the UK in 2004 vary from around £13 billion to £60 billion.<sup>8</sup> Based on this, the parties' combined share of supply ranged from [1-5] per cent (increment [ $< 1$ ] per cent) to [5-10] per cent (increment [1-5] per cent). Combined shares of supply by sector ranged from [1-5] per cent (local authority work) to [5-10] per cent (corporate sector work).
33. Like construction services, there are a number of UK FM providers who are larger or of a similar size to the combined size of Carillion and Mowlem. These include Rentokil Initial, Serco Group, Land Securities Trillium and Sodexo.

#### **Barriers to entry and expansion**

34. The parties considered entry barriers to FM services to be low. Labour is often subcontracted. One third party provider told that OFT that there were a number of entrants around five years ago but that there has been little significant entry since then.
35. However, given the lack of competition concerns, it is not necessary to reach a conclusion on barriers to entry.

#### **Buyer power**

36. Given the lack of competition concerns it is not necessary for the OFT to reach a conclusion on countervailing buyer power.

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<sup>8</sup> MBD (Mintel) and i-FM.

## **Portfolio effects**

37. Based on data provided by the parties, combined, the parties will be the third largest construction company and the fourth largest FM provider in the UK. The OFT has considered whether links between construction and FM services are such that the merger between Carillion and Mowlem raises portfolio power concerns. Namely, the OFT has considered whether the proposed merger could directly strengthen the feasibility of strategies designed to deter entry and/or reduce or eliminate the competitive constraint imposed by firms in neighbouring markets (these are known as portfolio effects).
38. However, no portfolio power concerns were raised with the OFT despite two third parties telling the OFT that a firm winning the construction contract may have an advantage in bidding for the FM contract.<sup>9</sup> What is more, there are a large number of successful FM suppliers not active in construction. Consequently, the OFT does not consider that portfolio power concerns arise in this case.

## **VERTICAL ISSUES**

### **Construction**

39. Edgar Allen (a subsidiary of Mowlem) is an upstream manufacturer of track components (switches, crossings and turnouts (which incorporate switches and crossings)). The parties estimated the supply of switches, crossings and turnouts were worth around £[60-70] million in the UK in 2004, which would give Edgar Allen a share of supply of [30-40] per cent.
40. This transaction will not affect the share of supply at the upstream manufacturing level (there is no overlap with Carillion), and the increment to the share of supply at the construction contractor level is negligible. Therefore, as a result of the proposed merger between Carillion and Mowlem there is no change in the parties' ability (or incentive) to foreclose competition at the contractor level by refusing to supply competing contractors with switches, crossings and turnouts.

### **Facilities management**

41. As well as providing individual FM services directly, both Carillion and Mowlem provide TFM services, through which they subcontract work to third party suppliers.

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<sup>9</sup> Nevertheless, the majority of third parties maintained that the construction contract would not influence the award of the FM contract.

42. The parties have submitted to the OFT that in this area their combined share of supply would be below 5 per cent. Therefore, the parties would not have the ability or the incentive to refuse to use other providers of TFM services as subcontractors.

### **THIRD PARTY VIEWS**

43. No third party was opposed to the proposed merger. For both construction and FM services, customers felt that there would be enough choice and competition after the merger to ensure that there would not be any competition concerns.
44. A number of FM services customers commented to the OFT that they would consider switching some or all of their FM requirements in-house if prices were to rise substantially.

### **ASSESSMENT**

45. For construction services, the parties' combined share of supply is small (whichever measure is used). Further, there are a number of other construction firms which are larger or of a similar size to the combined size of Carillion and Mowlem. These firms include Balfour Beatty, Bovis Lend Lease, Laing O'Rourke and Costain. All had a share of supply of less than 10 per cent (based on 2004 data). In addition, there are many construction firms with shares of supply of less than 2 per cent (the parties considered that there were around 1,200 UK construction firms in total).
46. Construction customers are unconcerned about the proposed merger.
47. Therefore, based on the lack of concentration in the construction industry and third party responses, it is considered that after the merger there will be sufficient competitive constraints acting on the merged entity. This is the case regardless of whether construction is segmented into categories of type of work or into industry sectors.
48. For FM services, it is also the case that the parties' combined share of supply is small. The evidence suggests that there will be a number of FM services suppliers of a similar size or larger than Carillion and Mowlem combined providing a competitive constraint on the merged entity.
49. Some customers told the OFT that it would be possible and financially feasible to bring their FM requirements in-house as a response to a price rise of around 5-10 per cent. Therefore, it seems that there is at least the possibility that the threat of in-house provision provides a competitive constraint on FM suppliers.

50. In addition, it is not considered that there are any portfolio power concerns as a result of this transaction. Furthermore, the merger will present no change in the parties' ability or incentive to use Edgar Allen to foreclose competition in rail construction and maintenance. A vertical issue does not seem to arise in regard to FM services.
51. 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**

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