

Anticipated acquisition by GB Oils Limited of Pace Fuelcare Limited

ME/4924/11

The OFT's decision on reference under section 33 given on 24 June 2011. Full text of decision published 20 July 2011.

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**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. **GB Oils Limited (GB Oils)** is a wholly owned subsidiary of DCC plc (DCC) and operates as DCC's oil distribution business in Great Britain, distributing heating and transport fuels and fuel oils to domestic, commercial, industrial and agricultural customers throughout Great Britain. GB Oils operates under a number of different brands, principally: Bayford Oil, Brogan Fuels, Carlton Fuels, CPL, Emo Oil, F.Peart & Co., Gulf, Scottish Fuels, Southern Counties, Team Flitwick, and Town & County Fuels (as well as other regional and local brands). On the Isle of Wight, GB Oils operates under the Vectis Oils brand. It also retails fuels under brands including Shell, Gulf and Texaco. GB Oils' turnover for the year ended 31 March 2010 was around £2.4bn, all of which was achieved in the UK.
2. **DCC plc (DCC)** a sales, marketing, distribution and business support service group headquartered in Dublin and listed on the Irish and London Stock Exchanges. DCC has five core divisions; DCC Energy, DCC SerCom (IT and entertainment products), DCC Healthcare, DCC Environmental and DCC Food and Beverage . DCC Energy is an oil procurement, sales, marketing and distribution, liquefied petroleum gas (LPG) and fuel card services business in Great Britain, Ireland, Denmark and Austria.
3. **Pace FuelCare Limited (Pace)** is a wholly owned subsidiary of Pace Petroleum Limited, itself a wholly owned subsidiary of Refined Holdings Limited, which in turn is a wholly owned subsidiary of MRH (GB) Limited

(MRH), the ultimate parent company of MHR Group of companies.<sup>1</sup> Pace is a distributor of transport fuels and heating oils trading in the South East, South West, East Anglia, the Midlands, the Home Counties and the Isle of Wight. It distributes transport fuels and heating oils to just under 80,000 customers, trading from 19 depots in (Mainland) England and one terminal on the Isle of Wight, as well as a number of barges on the River Thames. Pace trades only under the Pace Fuelcare brand in respect of its oil distribution business. Pace's turnover for the year ending 27 September 2009 was approximately £133m.

## **TRANSACTION**

4. The parties entered into a sale and purchase agreement on 16 February 2011 pursuant to which GB Oils proposes to acquire the entire issued share capital of Pace from Pace Petroleum Limited. The agreement is, inter alia, conditional on OFT clearance.
5. The parties notified the transaction to the Office of Fair Trading (OFT) on 22 March 2011. The OFT's administrative deadline for deciding whether to refer the merger to the Competition Commission (CC) is 1 June 2011.

## **JURISDICTION**

6. As a result of this transaction GB Oils and Pace will cease to be distinct. The UK turnover of Pace exceeds £70 million so the turnover test contained in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. Therefore the OFT 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**

7. The areas of overlap between the parties relate to the distribution of heating oils and transport fuels in GB.

### **Product scope**

8. Both parties distribute heating oils and transport fuels to domestic, commercial, industrial and agricultural customers. There are four basic oil

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<sup>1</sup> MRH is one of the biggest independent fuel retailers in the UK. The Group owns and operates around 300 petrol stations, with a fuel volume totalling around 1.1 billion litres per year. The petrol stations will be retained by MRH post-merger.

products supplied by both GB Oils and Pace: diesel; gas oil; kerosene and petrol.

9. In GB Oils/Brogans<sup>2</sup> the OFT received evidence to suggest that demand-side substitution between these products was found to be limited.<sup>3</sup> On the supply-side, the OFT stated that there were circumstances where the OFT may aggregate several narrow markets into one broader one on the basis of considerations about the response of suppliers to changes in prices. In particular, the OFT may do so when production assets can be used by companies to supply a range of different products that are themselves not demand-side substitutes, and the companies have the ability and incentive quickly (generally within a year) to shift capacity between these different products depending on the level of demand for each.
10. In this respect, in GB Oils/Brogans<sup>4</sup> the OFT believed that it may be appropriate to aggregate separate demand-side markets to include all types of heating oils and transport fuels on the basis of these supply-side considerations. However, the OFT concluded that it was not necessary to conclude on the precise product market definition as, irrespective of whether it aggregates these markets or not, there is a realistic prospect of a substantial lessening of competition as a result of the merger.
11. Consistent with the analysis undertaken in GB Oils/Brogans,<sup>5</sup> the OFT has, in this case, considered whether these fuel types constitute separate markets or a single market. The OFT has received insufficient evidence to suggest that it would be appropriate to depart from its previous findings in DCC/CPL<sup>6</sup> and GB Oils/Brogans.<sup>7</sup> Therefore, in this case the OFT, again, is of the view that the precise market definition taken - whether it includes all heating oils and transport fuels together or whether subdivided between heating oils and transport fuels or by reference to a particular type of fuel –

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<sup>2</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

<sup>3</sup> Similarly in OFT decision on the anticipated acquisition by DCC PLC of CPL Petroleum Limited, (DCC/CPL) 24 August 2007.

<sup>4</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

<sup>5</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

<sup>6</sup> OFT decision on the anticipated acquisition by DCC PLC of CPL Petroleum Limited, (DCC/CPL) 24 August 2007.

<sup>7</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

does not affect the assessment of the competition effects arising from the merger.

12. In addition, the OFT has also considered in this case whether it would be appropriate to define separate markets based on customer type or season.<sup>8</sup> Information received from third parties suggests that the competitive environment may vary in the supply to different customer types (domestic customers, regional and national customers) and at different times of the year. Indeed, the OFT believes that the merger may impact disproportionately on some customer types and consumers at some times of the year. However, again, it has not been necessary to conclude on these issues, given that this does not impact on the outcome of the competition assessment. Notwithstanding a precise market definition, however, the OFT believes that the parties compete most closely on local deliveries of heating oil to smaller customers (including domestic customers), and therefore the focus of the competitive effects assessment below relates to this area of business.

### **Geographic scope**

13. GB Oils is active in the supply of oil throughout Great Britain, while Pace's activities focus in the South of England, the Midlands and East Anglia. Both parties distribute on the Isle of Wight.
14. The OFT understands that suppliers typically deliver oil and fuels direct to customers (for example, petrol stations). Therefore, the boundaries of the geographic market are determined by how far suppliers are prepared to travel to deliver oil and fuel to their customers. The parties consider that the relevant geographic market should be national. The parties submitted a number of pieces of evidence and argumentation in support of this proposition. In terms of its own activities, GB Oils submitted that it operates a model based on high depot density and on the basis of a supply range of 30-50 miles around its depots. This radius would be higher in rural, less populated areas and lower in more densely populated, urban areas.

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<sup>8</sup> See Merger Assessment Guidelines, A joint publication of the Competition Commission and the Office of Fair Trading, September 2010, paragraph 5.2.5(c) stating that 'The relevant customer market: when suppliers can target higher prices at those customers willing to pay more than others (that is, price discrimination), the market may be defined by customer group, with the customers in each market being offered different terms. When different suppliers can meet customers' requirements at different times, the relevant customer market may have a temporal dimension.'

However, the parties consider that some other distributors with fewer depots tend to transport oil over greater distances. The parties also submitted that there are a large number of small distributors that operate from a single site and which would be willing to transit oil over much greater distances. The parties argue that the ability to transport oil over long distances, and to compete in new areas at short notice, points strongly to regional or national markets rather than local markets. In addition, the parties provided evidence from a website called 'Boilerjuice' which they submit indicates that distributors are willing to supply to customers located some distance away, greater than 30 miles from their depots. In their view, this indicates that competitors can offer competitive prices even if they incur higher costs associated with longer driving distances.

15. Furthermore, the parties stated that analysis of the market by reference to a supply radius around a depot would ignore the ability of distributors to serve customers directly from refineries or terminals. In this respect, the OFT notes that few domestic or small commercial customers are likely to be served by articulated tankers carrying fuel from a terminal/refinery. The parties stated that oil can be transported significant distances from refineries or terminals and referred to the indicative analysis presented to the OFT in GB Oils/Brogans,<sup>9</sup> showing that the costs of supplying direct from a terminal over significant distances were, in certain cases, only marginally higher than supply from a depot and, in some cases, marginally lower.
16. In this case, third party enquiries revealed a preference among some smaller customers to use local suppliers. The OFT also received representations from third parties that some distributors are likely to only be able to supply domestic customers cost-effectively up to a 10-30 mile radius from their depot.
17. The OFT also considered in this case whether, in addition to local markets, it would be appropriate to define one or several regional markets matching with regional contracts tendered by customers requiring delivery of fuel and heating oil over multiple sites. The views of large customers were mixed, but there does appear to be a preference among a significant proportion of larger regional customers to contract with distributors with a similar

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<sup>9</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

geographic reach to themselves. However, on the basis that few strong concerns were raised among customers tendering regional contracts, the OFT did not consider it necessary to conclude on this point.

#### Isle of Wight

18. As noted above, the parties overlap in the distribution of heating oil and transport fuels on the Isle of Wight. They both distribute oil from a terminal located on the Isle of Wight and operated by Pace. The parties argued that the Isle of Wight should not be considered a separate geographic market for a number of reasons. In particular, the parties argued that the transport of fuels from the mainland is a realistic alternative to the current distribution model used by the parties on the Isle of Wight. In addition, they argued that there are a number of distributors (Watson Fuels, Total Butler and NWF/Evesons Fuels) with wet depots located close to Southampton Water, where the ferry service for Isle of Wight departs, that could supply to customers on the Isle of Wight. Furthermore, the parties stated that there is evidence demonstrating that Tesco currently purchases transport fuel from the Mainland and has this transported across to its retailers on the Isle of Wight and that Sainsbury's used to bring supplies from the mainland in 2009.
19. However, the OFT received a number of third party comments from customers on the Isle of Wight stating that there were no other alternative distributors to the parties that they would be able to switch to post-merger. None of these customers mentioned distributors with wet depots on the mainland as alternatives to the parties. In addition, one competitor stated that the transport of heating oils and transport fuels to the Isle of Wight by ferry was problematic due to the limited capacity of ferries and health and safety restrictions considering that fuel is a hazardous substance. In particular, the same competitor stated that any tanker delivering to the Isle of Wight from the mainland would likely only be able to complete one trip per day considering that the transport of fuel needs to be made on the night-time ferries, whereas a tanker delivering directly from the terminal on the Isle of Wight may be able to supply two to three tanker-loads per day.
20. Further, the OFT understands that, although Tesco transports fuel from the Mainland, it purchases this from a supplier that it part owns and—as a vertically-integrated self-supplying user of fuel—does not sell fuel into the 'merchant market'. Consequently, the OFT is of the view that the Tesco

example is not probative of geographic market definition. When the OFT pointed this out to the parties in the issue meeting, they responded that the evident lack of competitive interaction between the Mainland and the Isle of Wight was still consistent with Mainland prices constraining those on the island. The OFT notes that the parties produced no evidence to support this position.

## **Conclusion**

21. While it could be argued that distributors of heating oils and transport fuels can technically deliver to customers irrespective of their proximity to the depots, the OFT is of the view that distributors are unlikely to be competitive in areas where they have a weak distribution network, particularly for small volume deliveries, such that specific customers are likely to consider only those suppliers with depots within their locality as potential suppliers.
22. Based on the evidence available to it, the OFT understands that distributors deliver heating oil and transport fuels to large customers with multiple sites on a national or regional basis, but make small deliveries to domestic and commercial customers on a more local basis. Therefore the OFT cannot rule out the hypothesis that the geographic scope of supply could be considered on a national, regional and local basis. Therefore, the OFT has considered the impact of the merger both at a local, regional and national level. In addition, the OFT concludes that the Isle of Wight is a separate market and has assessed the impact of the merger on the Isle of Wight separately.

## **HORIZONTAL ISSUES**

### **Mainland**

#### National level

23. On a national level, and across all fuel oil types and all types of customer, GB Oils is one of the largest distributors of fuels in terms of volume of

supply. In particular, according to GB Oils's 'addressable' market<sup>10</sup> GB Oils is estimated to be the second largest supplier nationally with 12 per cent share, superseded by Greenergy with 15 per cent and followed by a number of oil majors and traders. The acquisition of Pace represents an increment of only [zero to five] per cent. The parties argued that they will continue to face strong competition from the major national and multi regional distributors (such as Watsons Fuels, Total Butler, BWOC, NWF, WCF, Crown Oil, Rix Petroleum and Goff Petroleum), a large number of regional distributors (such as Fuel Oils, Chandlers, Tincknell Fuel, Barton Petroleum, Callow Oils, Severn Fuels and many others) who have multiple depots covering at least one region, and a very large number of local distributors who tend to compete on a regional or local basis. In addition, the parties argued that they will continue to face strong competition from the oil majors and traders for large customers, retail and national accounts.

24. However, the OFT considers that the merger may have a disproportionate impact on some specific types of customers. In particular the OFT notes that GB Oils and Pace both operate wet depot networks that are necessary for the efficient supply of small volume deliveries. The parties provided additional estimates of national market shares that the OFT considers are more commensurate with the supply of fuel to smaller customers by independent distributors.<sup>11</sup> Evidence available to the OFT similarly illustrated that GB Oils is the largest distributor of small deliveries of heating oils (kerosene) to domestic customers in the UK.
25. Both the parties' estimates and the evidence available to the OFT indicate that GB Oils is two to three times as large as its nearest rivals in the supply to such customers with Total Butler, Watsons Petroleum and Goff Petroleum significantly smaller. Pace is the fifth largest distributor on this basis. The difference is even more pronounced when considering the number of wet depots operated by these firms. Total Butler operates the second largest number of depots in the UK but this number is estimated to be less than a third as many as GB Oils. However, the OFT did not receive

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<sup>10</sup> This includes national accounts, large commercial customers, independent retailers, agricultural customers, small commercial customer and domestic customers and customers for marine oil and aviation fuels. It does not include sales made to or by oil majors/traders owned retail forecourts or supermarket owned retail forecourts. It also excludes certain aviation fuel volumes sold by the oil majors/traders to customers that GB Oils considers to be outside its addressable market. As regards products, these include petrol, kerosene, diesel and fuel oils.

<sup>11</sup> These exclude sales by oil majors and traders, sales by distributors to national account customers and large commercial customers and sales to retail forecourts.



many third party comments in relation to the impact that the merger may have on a national level for the distribution of heating oils and transport fuels in the UK either in general or with respect to specific groups of customers.

26. Therefore, despite GB Oils being the largest distributor of heating oils and transport fuels in the UK (in particular in relation to domestic customers), GB Oils and Pace do not compete closely on a national level and the increment as a result of the merger is relatively small. In addition, the OFT understands that there are a number of other distributors with a national presence that will continue to impose a constraint to the parties. In this respect, the OFT concludes that the merger does not give rise to a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in the UK as a whole.

#### Regional level

27. Considering that the geographic area of overlap between the parties is limited to the Midlands, South England and East Anglia, the OFT examined the impact of the merger within the geographic area served by Pace.
28. The parties were unable to provide any regional market share estimates for this overlapping geographic area ('the Pace area'). However, notwithstanding the parties' arguments that depot numbers may be a misleading proxy by which to assess the strength of competition between distributors in the Pace area, the OFT undertook some research to assess the significance of depot networks in this area.
29. The OFT estimated, based on the number of depots in the Pace area, that the merged entity will have a share of approximately 26 per cent, with an increment of between nine and 13 per cent (depending on the exact definition of the overlap area).
30. In addition, the OFT identified that there were two other fairly dense depot networks, covering the whole of the Pace area, namely Total Butler and Watsons Petroleum. Furthermore, the OFT identified Mabanaft and NWF/Evesons with smaller but significant depot networks across the Pace area and a number of other operators with multiple depot facilities (Goff Petroleum, Fuel Oils, Barton Petroleum, Chandlers, Tincknell Fuels, Callow

Oils), who were typically concentrated in specific localities within the Pace area.

31. The OFT received very limited third party concerns in relation to the impact of the merger at a regional level. Although the majority of customers made no comments or had no particular concerns, a couple of third parties highlighted that the merger would reduce their choice of distributors with multiple depot facilities.
32. Based on the evidence available to it, the OFT understands that on a regional level, there are at least two other competitors, Total Butler and Watsons Petroleum, who will continue to impose a competitive constraint to the parties post-merger. In addition, the OFT understands that there are a number of operators with smaller depot networks who are capable of imposing some degree of constraint to the parties as well. Therefore, the OFT concludes that the merger does not give rise to a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels on a regional level, namely within the Pace area.

#### Local Level

#### Methodology

33. There are several local areas across the Mainland where the parties' depots are situated either within each other's catchment area (as defined by a 10, 20 or 30 mile radius around a depot) or, if not, where the parties' catchment areas substantially overlap.
34. In considering the reduction in competition that may occur at a local level, the OFT initially considered as effective competitors only those with a depot within the vicinity of the overlap.<sup>12</sup> On this basis, in the majority of localities, customers would continue post-merger to have a sufficient number of alternative suppliers within the local area.
35. However, the OFT retained some preliminary concerns regarding those overlaps containing customers for whom the parties may have been their closest suppliers or where the parties have an extensive network of depots

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<sup>12</sup> The OFT considered the impact of the merger within each local area where the parties' depots overlapped (20 overlaps). However, since competition issues did not arise in any locality, other than the Isle of Wight, it is not necessary for each overlap to be presented in detail.

in the wider area surrounding the specific locality. In particular, the OFT analysed each local overlap by taking into consideration the reduction of fascia post-merger but also the strength of competition that may vary in each local overlap according to the wider regional/national presence (network of depots) of other distributors.

36. As mentioned above, in the Pace area, the OFT identified that there were two relatively dense depot networks covering the whole overlap area, Total Butler and Watsons. In addition, the OFT also identified a number of operators (Mabanaft, NWF/Evesons) with smaller but significant depot networks across the overlap area and other operators with multiple depot facilities – at least two depots - (Goff, Fuel Oils, Barton, Chandlers, Tinknell, Callow), who were typically concentrated in specific localities within the Pace area. Therefore, the OFT examined whether in any overlapping area there were at least three alternative distributors, two of whom were distributors with multiple depot facilities within or just outside the catchment area that could provide a competitive constraint to the merged entity post-merger.

#### Third party views

37. Third party views were mixed regarding the appropriate catchment area of individual depots. However, at one extreme, a distributor argued that 50 miles was the maximum they would travel, and 30-35 miles would be too far to service domestic deliveries. The same distributor considered that the delivery distance would be limited to 10 miles for a distributor with two or three tankers. A competitor operating from one depot confirmed that while a tanker might travel 60-120 miles along any one delivery route (known as a 'milk round'), it would not travel further than a 20-mile radius from its depot.
38. Evidence from third parties on the constraint posed by small distributors was mixed. Some, but not all, third parties considered that smaller distributors might not possess the buying power of the larger distributors such that they have to differentiate themselves on the basis of service. Finally a few third parties raised concerns related to the impact that the merger may have on capacity within the fuel distribution market, in particular where the merged entity could close overlapping depots and therefore remove spare capacity from the market.

## Parties' arguments

39. The parties argued that they face competition from competitors from a greater distance than might be implied by basing a catchment area on the typical supply radius of GB Oils's depots. In particular, the parties stated that GB Oils's high concentration of depots has been shaped by, among other things, their previous acquisitions. Furthermore, the parties stated that the presence or absence of a depot does not, in itself, indicate the level of constraint posed by a competitor on the parties. This is because a significant proportion of deliveries are made direct from the oil refineries or terminals.
40. The parties also argued that a depot was simply a warehouse and that the availability of product and trucks determined the quantities available and delivered to customers.
41. In addition, evidence provided to the OFT by the parties, indicated that the costs of supplying customers directly from a terminal/refinery, rather than a depot, are not materially higher. Indeed, the parties stated that an articulated vehicle could, to a certain extent, replicate the storage function carried out by a depot.
42. The parties argued that supplying customers cost effectively relies on the ability to establish a route of customers. Therefore, the viability of a 'milk round' does not depend on how far individual customers lie from each depot but rather on their proximity to the distribution route and so the incremental cost of supplying them.
43. Furthermore, the parties submitted that the OFT should not distinguish between the constraint posed by smaller distributors and that imposed by larger distributors who may have a more extensive network of depot infrastructure. In particular, they stated that there are no economies of scale in purchasing oil from oil majors and provided examples of local operators and smaller distributors that operate from a lower cost base who are able to offer customers choice and drive down price and drive up service quality. In addition, the parties submitted some evidence illustrating the magnitude of the competitive constraint small distributors exercise on a daily basis.

44. In addition, the parties stated that it was easy for existing distributors to supply customers in new geographic areas. The parties described several routes by which such expansion is possible: parking tankers in a new local area or operating out of third party depots, terminals or refineries. They highlighted examples showing competitors who had recently targeted business in a new area by building new depots or using third party parking space.
45. Finally, in relation to the impact that the merger might have on capacity in the distribution of heating oils and transport fuels, the parties stated that the availability of product and trucks (not depot numbers) determines the product quantities available and delivered to customers. In addition, the parties argued that they already possess sufficient spare capacity to be able to cope with predictable demand even during peak summer or winter months. In particular, the parties stated that the supply difficulties in winter 2011 were not caused by lack of capacity at the distribution level, but by other factors which reduced the ability to operate at capacity, such as shortage of product from refineries, unsafe road conditions and driver sickness, customer's purchasing behaviour.

#### OFT's assessment

46. Based on the evidence available to it, the OFT understands that relying on depot numbers may provide a misleading indication of the strength of competition in each local area. Depots are not homogenous in terms of either storage capacity or the number of tankers housed there. However, the OFT could not rule out that a distributor with a network of depots could be expected to impose a stronger constraint to the merged entity than a small distributor with a single depot facility. In addition, the OFT is aware that during peak times of demand prices and service levels can deteriorate (such as waiting time) as the infrastructure is placed under pressure. The OFT also expects that the parties would likely rationalise capacity in terms of depots, tankers and/or staff post merger in order to make efficiency gains. In a market already exhibiting signs of being capacity constrained during periods of peak demand (winter and harvest time) based on customers' comments—and pre-supposing the parties had a very high proportion of total capacity in any one or more areas—the OFT would have concerns over the impact that further capacity reduction may have on prices and quality of service.

47. Therefore, the OFT applied the above methodology (paragraphs 31-34) in all overlapping areas and concluded that across each locality where the parties have depot facilities, at least three competing distributors, two of which have multiple depot facilities, will remain to provide a constraint on the parties post-merger—including competitors from outside the locality. In addition, the OFT also believes that, since the parties do not have more than 50 per cent of depots in any local area, the impact of any depot closures post-merger is not expected to be sufficient to create a substantial lessening of competition as a result of the merger.
48. Therefore, the OFT concluded that there is no realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in local areas in the Mainland on this basis.

### **Isle of Wight**

#### **Competitive Assessment**

49. Pace owns the marine-fed storage terminal in Cowes, and operates a distribution business on the Isle of Wight. This business sources oil from its Cowes terminal. GB Oils also purchases oil from the Pace terminal and supplies customers on the Isle of Wight directly as it does not have its own wet depot on the island. GB Oils' brand on the Isle of Wight is Vectis.
50. The parties are the only two independent distributors of heating oils and transport fuels on the Isle of Wight.
51. Customers on the Isle of Wight stated that post-merger they would have no choice other than purchasing heating oils and transport fuels from the merged entity. The majority of customers were unable to name any other distributors that they considered as an alternative supplier to the parties.
52. In addition, it has been put to the OFT that, once competition between the parties is removed, the merged entity may have the incentive and ability to increase prices and/or reduce service levels due to the loss of an independent constraint.
53. Therefore, the merger will reduce the number of current independent distributors on the Isle of Wight from two to one.

## Competition from the Mainland

54. The OFT examined whether the threat of supplying heating oils and transport fuels from the Mainland or of a new entry to the Isle of Wight would be sufficient to constrain the parties from raising their prices or reducing their quality service levels post-merger.
55. In this regard, the parties argued that the threat of supplies from the Mainland or new entry will act as a significant constraint to the merged entity. In particular, the parties stated that there are two principal freight ferry routes to the Isle of Wight, the Red Funnel roll-on, roll-off service from Southampton to Cowes, and the Wightlink roll-on, roll-off service from Portsmouth to Fishbourne and both of these offer daily frequent services through the day and night.
56. In addition, the parties argued that while weather and other problems can affect services from time to time, these are unlikely, in practice, to have a material impact on the feasibility of transporting fuel by ferry to the Isle of Wight. The parties pointed out that the Fawley refinery (owned and operated by ExxonMobil) and the BP Hamble oil storage terminal on the Mainland are located within 30 miles of Pace's Cowes terminal on the Isle of Wight. These are located on, or close to, Southampton Water (where the Red Funnel Car ferry departs) and there are a number of distributors, according to the parties, with wet depots strategically located on, or near, Southampton Water or who currently are sourcing out of the Fawley refinery and therefore could be considered potential competitors on the Isle of Wight.
57. In addition, the parties provided data showing that oil could be supplied from the mainland at a lower price than supplied by Pace's Cowes terminal. However, the OFT has not been provided with any examples of actual entry to the Isle of Wight market from the mainland. [ ]
58. In this regard, one competitor mentioned that it would be possible to start supplying oil to the Isle of Wight sourced from the Mainland but that there are a number of disadvantages. In particular, there is limited capacity to transport fuel by ferries and health and safety restrictions. Further, rough weather could disrupt deliveries. In addition, a tanker delivering to the Isle of Wight from the mainland would likely only be able to complete one trip per day, according to third party views, whereas a tanker delivering directly

from the terminal on the Isle of Wight may be able to supply two to three tanker-loads per day. In their view supply by ferry was therefore not a practical solution. Further, a competitor active on the mainland stated that an investment of approximately £500,000 would be needed to set up a wet depot on the Isle of Wight. Even then, they would expect to face resistance from the parties such that they would not expect to make a return for a number of years as they 'bought' their way into the market. The strong presence of the parties on the island was therefore seen as an important barrier to entry.

59. The parties argued that while there are certain costs (ferry costs and opportunity cost in the additional time taken in the crossing) and health and safety restrictions on the transport of fuels by ferry, these factors must be balanced against the opportunities open to distributors on the Mainland to purchase oil at lower cost than on the Isle of Wight. The parties stated that the threat of Mainland supplies is real considering that Tesco is currently purchasing transport fuels from the Mainland and there have been threats to Pace by Sainsbury's and Morrison's to import directly from the Mainland in the past.
60. Finally the parties argued that a distributor planning to expand onto the Isle of Wight could establish a wet depot on the island with a cost of as low as [ ] or alternatively they could bring supplies onto the island by articulated truck and transfer to four-wheeler/six-wheeler tankers located on the island.

## **Conclusion**

61. As a result of the evidence available to it and the number of concerns raised by third parties, the OFT concludes that the merger will reduce the number of distributors on the Isle of Wight from two to one and the threat of supply from the Mainland would not, on its own, be an effective constraint. The OFT therefore believes that there is a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in the Isle of Wight resulting from the merger.

## **Barriers to entry and expansion**

62. The question for the OFT is whether entry into the distribution of heating oils and transport fuels in the Isle of Wight would be likely, timely and



sufficient enough to deter any attempt by the parties to raise prices or reduce service quality.

63. Based on the evidence available to it, as analysed above, the OFT cannot be sufficiently confident that entry to the Isle of Wight is likely, timely or sufficient to constrain GB Oils post merger.

### **THIRD PARTY VIEWS**

64. The OFT received a number of third party views regarding the merger. In particular, the OFT received comments from competitors and customers.
65. In relation to the Mainland, the OFT received only a very few comments regarding the impact of the merger at a national level. Similarly, at a regional level only a couple of customers mentioned that the merger would result in the reduction of choice of distributors with multiple depot facilities. These views have been discussed above.
66. Comments from third parties primarily addressed the impact of the merger at a local level. Third parties stated that the merger would reduce the number of distributors in a number of localities and that the merged entity would have high market shares. In addition, third parties stated that the merger could result in the reduction of capacity in certain areas. All these views have been discussed above.
67. Finally, in relation to the distribution of heating oils and transport fuels on the Isle of Wight, the OFT received a large number of third party comments, stating that the merger would reduce the number of distributors from two to one and that there would be no alternative distributor to get supplies from. These are also discussed above.

### **ASSESSMENT**

68. The parties overlap in the distribution of heating oils and transport fuels in Great Britain.
69. In relation to the distribution of heating oils and transport fuels, the OFT considered it appropriate not to depart from its previous findings in

DCC/CPL<sup>13</sup> and GB Oils/Brogans<sup>14</sup> and is of the view that whatever the precise market definition taken - whether it includes all heating oils and transport fuels together or whether subdivided between heating oils and transport fuels or by reference to a particular type of fuel – does not affect the assessment of the competition effects arising from the merger. In addition, the OFT examined the impact of the merger at a national level, regional level and local level. In doing so, the OFT gave particular consideration to the Isle of Wight, where it received a large number of complaints.

70. At a national level the OFT accepts that GB Oils is the largest distributor of heating oils and transport fuels in the UK and in particular in relation to domestic customers. However, the OFT also understands that GB Oils and Pace do not compete closely on a national level and that the increment as a result of the merger is relatively small (approximately [zero to five] per cent). In addition, the OFT understands that there are a number of other distributors with a national presence that will continue to impose a constraint to the parties. In this respect, the OFT concludes that the merger does not give rise to a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in the UK as a whole.
71. At a regional level the OFT examined the impact of the merger within the geographic area served by Pace. The OFT estimated that the merged entity will have a share of depots in the Pace area of approximately 26 per cent, with an increment of between nine and 13 per cent (depending on the exact definition of the overlap area). Based on the evidence available to it, the OFT understands that on a regional level, there are at least two other competitors, Total Butler and Watsons Petroleum, who will continue to impose a competitive constraint to the parties post-merger. In addition, the OFT understands that there are a number of operators with smaller depot networks who are capable of imposing some degree of constraint to the parties as well. Therefore, the OFT concludes that the merger does not give rise to a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels on a regional level, namely within the Pace area.

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<sup>13</sup> OFT decision on the anticipated acquisition by DCC PLC of CPL Petroleum Limited, (DCC/CPL) 24 August 2007.

<sup>14</sup> OFT decision on the completed acquisition by GB Oils Limited of Brogan Holdings Limited (GB Oils/Brogans) 20 April 2010.

72. At a local level there are several local areas across the Mainland where the parties' depots are situated either within each other's catchment area (as defined by a 10, 20 or 30 mile radius around a depot) or, if not, where the parties' catchment areas substantially overlap. The OFT analysed each local overlap by taking into consideration the reduction of fascia post-merger but also the strength of competition that may vary in each local overlap according to the wider regional/national presence (network of depots) of other distributors.
73. Based on the evidence available to it, the OFT applied the above methodology in all overlapping areas and concluded that across each locality where the parties have depot facilities, at least three competing distributors, two of which have multiple depot facilities, will remain to provide a constraint on the parties post-merger—including competitors from outside the locality. In addition, the OFT also considered that, since the parties would not have more than 50 per cent of depots in any local area, the impact of post-merger efficiency savings were unlikely to be significant. Therefore, the OFT concluded that there is no realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in local areas in the Mainland on this basis.
74. Finally, in the Isle of Wight the parties are the only two distributors of heating oils and transport fuels. Both parties are supplied with oil and fuel from Pace's terminal located on the Isle of Wight. The OFT received a large number of customer complaints that customers will have no choice in distribution post-merger and, as a consequence, that prices will increase or the quality of service reduce.
75. The OFT examined whether the threat of supplies from the Mainland or new entry will act as a significant constraint to the merged entity. In addition, the OFT examined data provided by the parties showing that oil could be supplied from the mainland at a lower price than supplied by Pace's Cowes terminal. However, the OFT has not been provided with any examples of actual entry to the Isle of Wight market from the Mainland. [REDACTED]. Therefore, as a result of the evidence available to it and the number of concerns raised by third parties, the OFT concludes that it would not be unreasonable to conclude that the Isle of Wight should be treated as a distinct market. The merger will reduce the number of distributors on the

Isle of Wight from two to one and the threat of supply from the Mainland would not, on its own, be an effective constraint.

76. Consequently, the OFT believes 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.

## **UNDERTAKINGS IN LIEU**

### **Introduction**

77. Where the duty to make a reference under section 33(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.
78. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Exceptions and Undertakings Guidance* states that undertakings in lieu of reference are appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut and capable of ready implementation.<sup>15</sup>

### **Divestments**

79. The parties indicated that in order to remedy any competition concerns identified by the OFT, and to avoid a reference to the Competition Commission, they would be prepared to offer undertakings in lieu. Specifically the parties offered to divest:
- either the Pace distribution business as currently conducted on the Isle of Wight including tangible and intangible assets, personnel, goodwill and supply contracts or

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<sup>15</sup> See OFT Mergers – *Exceptions to the duty to refer and undertakings in lieu of reference guidance* OFT1122, paragraph 5.7.

- the GB Oils (Vectis) business as currently conducted on the Isle of Wight including tangible and intangible assets, personnel, goodwill and supply contracts, and
- the Cowes terminal, currently owned and operated by Pace.

### **OFT's assessment**

80. The OFT considers that the parties' proposed divestment package is capable of clearly addressing the competition concerns identified above in a clear cut manner, in accordance with the scheme of the Act as well as the OFT's guidance and decisional practice. In particular, in relation to the divestment of the Cowes terminal, the OFT believes that such divestment is necessary since it removes the possibility that GB Oils may, post-merger, have the incentive/ability to foreclose the potential purchaser of the distribution business being also offered as part of the divestment package.<sup>16</sup>

### **Need for up-front buyer**

81. The OFT considered whether it was appropriate in the circumstances of this case to require that the relevant divestment(s) be made to an up-front buyer or buyers.<sup>17</sup>

82. The OFT will seek an up-front buyer where the risk profile of the remedy requires it, for example, where the OFT has reasonable doubts with regard to the ongoing viability of the divestment package and/or there exists only a small number of candidate suitable purchasers.<sup>18</sup>

83. In this case, the OFT considers there to be a small number of potential purchasers that would be capable of creating a suitable and effective remedy in such a way as to restore the pre-merger competitive levels.

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<sup>16</sup> The OFT did not analyse this in its competitive assessment of the merger. However, the OFT is of the view that post-merger the parties' incentives might change.

<sup>17</sup> An up-front buyer requirement means both that the proposed purchaser will be contractually committed by the time the OFT accepts the undertakings in lieu such that the OFT can be confident before relinquishing its duty to refer that there is actually a suitable buyer, and the OFT is then able to consult publicly on the suitability of the actual proposed divestment purchaser, as well as any other aspects of the draft undertakings, during the public consultation period.

<sup>18</sup> See OFT Mergers – *Exceptions to the duty to refer and undertakings in lieu of reference guidance* OFT1122, paragraph 5.33.

84. Therefore, the OFT concludes that it is appropriate to suspend its duty to refer only on the basis that GB Oils will seek an up-front buyer for the divestment in this case. The OFT will accept undertakings when GB Oils has agreed a provisional sale with a buyer acceptable to the OFT which can provide a sufficient competitive constraint to remedy the substantial lessening of competition created by the merger.

#### **Conclusion on undertakings in lieu**

85. As the parties have offered undertakings that the OFT considers are in principle clear-cut and capable of restoring pre-merger levels of competition the OFT considers it appropriate to suspend its duty to refer this case while it considers further whether to accept these in lieu of reference under section 73 of the Act.

#### **DECISION**

86. The OFT's duty to refer the anticipated acquisition by GB Oils Limited of Pace Fuelcare Limited to the Competition Commission pursuant to section 33 of the Act is suspended because the OFT is considering whether to accept undertakings in lieu of reference from GB Oils pursuant to section 73 of the Act.