OFFICE OF FAIR TRADING

Completed acquisition by GB Oils Limited of Brogan Holdings Limited

ME/4406/10

The OFT’s decision on reference under section 22 given on 20 April 2010. Full text of decision published 20 May 2010.

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: Carlton Fuels, CPL, Bayfords and Scottish Fuels. It also retails fuels under the Shell and Texaco brands.

2. **DCC plc (DCC)** is an international procurement, sales, marketing, distribution and business support service group headquartered in Dublin and listed on the Irish and London Stock Exchanges. DCC has five core businesses: DCC Energy, DCC SerCom (IT and entertainment products), DCC Healthcare, DCC Food and Beverage and DCC Environmental. 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. **Brogan Holdings Limited (Brogans)** is a privately held company, headquartered in Motherwell Scotland. Brogans' principal activities are the distribution of heating oils and transport fuels to domestic, commercial, industrial and agricultural customers in the North of England and Scotland,

and the operation of a fuel card business.[1] It operates 16 depots in England and Scotland. Brogans turnover for the year ending 31 May 2009 was approximately £305m. However, after excluding elements of the Brogans' business which were not part of this transaction (ironmongery and commercial property), the turnover was approximately £296m for the year ended 31 May 2009.

TRANSACTION

4. By virtue of a share purchase agreement completed on 15 December 2009, GB Oils acquired the entire issued share capital of Brogans.

5. The OFT became aware of the transaction through a number of complaints. The OFT sent a preliminary enquiry letter to DCC on 5 January 2010. On 12 January 2010, GB Oils and DCC gave initial undertakings to the OFT pursuant to section 71 of the Enterprise Act 2002 (the Act) to' hold separate' both businesses.

6. The OFT's statutory deadline for deciding whether to refer the merger to the Competition Commission (CC), extended under section 25(2) of the Act, is 20 April 2010.

JURISDICTION

7. As a result of this transaction GB Oils and Brogans have ceased to be distinct. The UK turnover of Brogans exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

8. The areas of overlap between the parties relate to the distribution of heating oils and transport fuels and the operation of fuel card services in the UK.

[1] The main Brogans businesses are Brogan Fuels, Thistle Petroleum, UK Fueline and Dieselink Services.

Product scope

Fuel card services

9. The parties state that a fuel card is a means for a company to manage and reduce transport cost. Fuel card companies, such as the parties, issue fuel cards to corporate customers for use by the customer's employees to purchase fuel at retail petrol stations that accept that card. A fuel card company effectively acts as an agent to the oil companies for the promotion of the company's fuel cards. Fuel card companies like the parties are not physically involved in the collection or supply of fuel, but they take on the credit risk in respect of customers. The parties state that such companies are remunerated by a rebate of the fuel purchased.

10. Based on the evidence available to it, the OFT is of the view that even if the product market were limited to fuel card services, the parties' combined share of supply of fuel card services in the UK would be no more than 5 per cent and so would not give rise to any competition concerns. Therefore, the OFT does not consider it necessary to cover fuel card services in any further detail in this decision.

Distribution of heating oils and transport fuels

11. Both parties distribute heating oils and transport fuels to domestic, commercial, industrial and agricultural customers. There are four basic oil products supplied by GB Oils and Brogans: diesel; gas oil; kerosene and petrol. The parties state that the distribution of heating oils and transport fuels should be the narrowest frame of reference.[2] Specifically they argue that—on the demand-side—while gas oil is generally used as heating oil, gas oil is also used by some customers as a transport fuel. In addition, kerosene is also used as a transport fuel in aviation. On this basis, the parties argue that there is demand-side substitution by customers between different heating oils and transport fuels.

[2] Heavy fuel oil is principally used for industrial (not domestic) boilers and as transport fuel in some marine boilers. In this case, given that there is minimal overlap between the parties in the supply of heavy fuel, when referring to different types of oil and fuel, the OFT is referring to kerosene, gas oil, diesel and petrol.

12. However, the OFT has received insufficient evidence to suggest that it would be appropriate to depart from the findings in DCC/CPL[3] in which demand-side substitution between these products was found to be limited.

13. On the supply-side, the parties consider that in practice the majority of distributors supply both heating oil and transport fuels. The parties stated that almost all tankers have separate compartments to allow simultaneous transport of fuels. In addition, the parties argued that suppliers were able to switch between different products in the short term as each type of fuel involves the same supply chain and the same storage and distribution infrastructure. On this basis, the parties argue that there is supply-side substitution between the distribution of different heating oils and transport fuels.

14. The OFT considers that markets are defined principally on the basis of demand-side substitution. However, there are 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.

15. In this regard, the majority of third suppliers agreed that the costs to them of switching between the distribution of these products in response to consumer demand are low. One distributor stated that most oils are interchangeable in delivery tankers with relatively easy cleaning regimes. Another distributor stated that as all road tankers must comply with ADR regulation,[4] they should be capable of carrying different types of fuel. However, they indicated that smaller tankers—which are not suitable for servicing petrol stations—tend to be used to deliver home heating oil.

16. Based on the evidence available to it, the OFT believes 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

[3] OFT decision on the anticipated acquisition by DCC PLC of CPL Petroleum Limited, (DCC/CPL) 24 August 2007.
[4] European Agreement concerning the International Carriage of Dangerous Goods by Road.

considerations. Where relevant differences arise on certain individual product markets, the OFT considers them explicitly below. However, the OFT concludes that, 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, as analysed further below.

Geographic scope

Introduction

17. GB Oils is active in the distribution of heating oils and transport fuels throughout Great Britain, while Brogans operates in Northern England and Scotland.

18. The OFT understands that suppliers typically deliver oil and fuels direct to the customers (that is, domestic and commercial premises). Therefore, the boundaries of the geographic market may be determined by how far suppliers are prepared to travel to deliver oil and fuel to their customers. The OFT considers that the willingness of a distributor to deliver further afield is likely to depend on:

- whether the distributor has enough customers in an area to justify the transportation of fuels and oils by tanker to that area

- or whether it is economical to establish a route (sometimes called a ‘milk round’) for supplying a number of customers along the way.

19. On the first point, the OFT understands that national account customers may be supplied at a regional or even national level, and large (that is, 'full tank') customers who can be competitively supplied directly from an oil terminal or refinery may be supplied by competitors situated outside of any given local area.

20. On the second point, evidence available to the OFT indicates that smaller customers appear more likely to be served from distribution depots (that is, not directly from the terminal or refinery). Thus, larger volumes of fuel can be transported from a terminal in articulated tankers, the fuel can then be broken down and delivered by smaller tankers.

21. Finally, the OFT considers that the threat of entry or expansion from neighbouring areas may also indicate that wider markets exist.

Northern England and Mainland Scotland

22. The parties consider that the relevant geographic market should be Great Britain. GB Oils submits that it operates 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. However, the parties consider that other distributors tend to transport oil over greater distances, as GB Oils operates a model based on a high density of depots (partly as a consequence of its previous acquisitions). Furthermore, there are a large number of small distributors, each operating from a single site, who would be willing to transport oil over much greater distances.

23. Since there is no natural break between England and Scotland, the parties submit that Scotland does not represent a distinct market. In particular, they argue that depots in the South of Scotland would compete directly with those in the North of England, whilst also competing with those in the Central Belt of Scotland. Furthermore, the parties submit that a similar situation exists in the Highlands, with no natural break between the Highlands and the rest of Scotland. Whilst the parties agree that there is a more limited road network, they believe that a chain of substitution still exists.

24. A number of third party distributors located in Scotland have indicated that although they do not have a maximum range of delivery from a depot for full loads, small customers they serve will typically be located no more than 30 miles away.

Local markets

25. The parties submit that even if economic supply radius were to be defined around individual depots/terminals, this would not point to local or even regional markets. The parties consider that a chain of substitution is likely to exist such that the pricing and policy decisions in relation to a single depot have an impact over an area well in excess of the economic supply radius of that depot. A supplier facing little or no competition from other depots based within the economic supply radius of a particular depot would still be constrained by the pricing decisions of depots outside of that radius.

26. The parties submitted that while they may serve a proportion of customers directly from a depot, they also make drops to customers along the route between the depot and the terminal/refinery (such as Grangemouth) where fuel is originally sourced. The parties gave an example where around half of one party's sales were to customers served directly from the depot, and the remaining 50 per cent were served along the supply route. As a consequence, the area over which they would be willing to supply a customer may include both a radius around a depot, but also along the supply route from a depot to an oil refinery (such as at Grangemouth).

27. The OFT considers that in cases where prices (and sometimes delivery costs) are listed, rather than being subject to negotiation, the relevant geographic market is the smallest area in which a hypothetical monopolist could profitably sustain a SSNIP. Proper application of the hypothetical monopolist test renders obsolete arguments about widening the geographic market on the basis of a chain of substitution. However, in the present cases where delivered prices are negotiated individually with customers, the geographic scope of a market may be one aspect of the definition of relevant markets based on customer groups.

28. So as to assess the boundaries of the relevant geographic market, the OFT sought to compare profit margins across different local markets where the number of suppliers differs. Profit margins appear to vary widely between the parties' depots, even after controlling for those variable costs which vary across depots (for example, transport costs). Although it was not possible for the OFT to control for every possible factor other than local competition that may affect profit margins, the parties appeared to earn higher profit margins in areas where there are fewer suppliers within a 15 to 30 mile radius (for example, Crieff and Forfar where Brogans faces no other competitor within 15-miles besides GB Oils) than in areas where there are more competitors (for example, Grangemouth, Clydebank and Motherwell where Brogans' depots each face at least 4 competitors within a 15-mile radius). On this basis, geographic markets appear to be local.

29. This was corroborated by the majority of third parties, who stated that their maximum delivery distance is limited by the distance a tanker can travel in a day. In addition, a large number of customers referred to distributors as viable suppliers only when they had a depot in the local area. Further, in their evidence on the degree of competition in several

localities, the parties provided a number of examples of small competitors with a distinct focus on serving the 'local community'. The ambit of these competitors' pricing and quality of service was clearly local.

30. The parties argued that the observed profit margins are a function of a number of factors that are not related to the number of competitors, including that:

- rural areas typically face higher costs and lower demand, leading to higher prices. Transport cost alone would not be sufficient to capture the higher costs of operating in rural areas, as driver hours are longer, while truck utilisation and route density is lower in rural areas

- average margins will be affected by the mix of products operating in a given area. Margins on kerosene tend to be higher than for gas or petrol, while margins for heavy fuel oil are substantially lower, and

- differences in customer profiles across depots will tend to affect margins, with commercial customers (typically higher volume customers) obtaining lower margins per litre, reflecting the lower costs of serving these customer types.

31. On this basis, the parties identified a number of local areas that did not fit the OFT's observed pattern between profit margins and local competition (for example, Dumfries and Huntley). Consequently, the parties submitted, even if the OFT considered the relevant geographic market to be local, there are constraints on the exercise of any local market power that the parties may have, principally ease of entry (see further below).

Western Isles

32. The parties both had depots on the Western Isles pre-merger. They argued that since the introduction of the Road Equivalent Tariff (RET) in October 2008, which sets ferry fares between Scotland and the Islands on the basis of the cost of travelling an equivalent distance by road, the costs to competitors on the mainland of supplying the Western Isles have fallen such that the threat of entry would deter future price increases by the merged party. In particular, the parties state that Brogans' original entry onto the Western Isles was facilitated by the scheme. The parties further argued that the profit margins at GB Oils' depot in Stornoway are no

greater than the profit margins achieved by other GB Oils depots on the mainland, an observation that they submitted is not consistent with the existence of local geographic markets.

33. In addition to the discussion above, in respect of the Western Isles, the majority of third party distributors indicated that they would not consider delivering there because of cost considerations. Furthermore, the majority of customers in Western Isles indicated that they were not aware of alternative suppliers on the Isle of Lewis. However, one customer stated that, following the completion of the merger, they contacted one supplier in mainland Scotland, who is now supplying them with diesel and petrol.

Conclusion

34. On the basis of the evidence before it, the OFT considers that there are at least some aspects of competition in the supply of transport fuels and heating oils (for example, service quality) that vary locally. However, regardless of the OFT's view of mainland Scotland, based on the evidence available to it, the OFT believes that the Western Isles form a separate relevant geographic market.

35. Nonetheless, irrespective of the precise market definition and on a cautious basis, the OFT examined the impact of the merger at a national as well as a local level.

HORIZONTAL ISSUES

Mainland Scotland and North England

36. The parties overlap in the distribution of heating oils and transport fuels in mainland Scotland and Northern England. The OFT examined the impact of the merger on a national basis (where the parties supply national account customers) and local basis and concluded that there is no realistic prospect of a substantial lessening of competition in any level.

National level

Market shares

37. Across Scotland and Northern England the parties are the two largest fuel distributors by number of distribution depots and the two largest independent distributors in terms of volume of supply.

38. In particular, the parties submitted that, across Scotland,[5] their share of supply would be in the region of 25 per cent with an increment of six per cent. In particular, the parties argued that oil majors (such as Esso, Shell, Petroplus and Total) and traders (such as Greenergy, Mabanaft and World Fuel Services) should be included in the same market as they directly compete with the parties. They argued that oil majors and traders compete directly to supply large customers and work co-operatively with distributors to supply smaller customers. In addition, the parties listed the next largest independent distributors in terms of volume as Highlands Fuels (five per cent), Gleaner Oils (three per cent) and Johnston Oils (two per cent) and Simpson Oils (two per cent). The parties further stated that there was a large tail of independent distributors that represented a competitive constraint to the parties.

39. The OFT understands that many of the oil majors do not supply directly to end-users aside from some large contracts. Indeed, many of the oil majors have sold their distribution businesses to independent distributors. To the extent that oil majors and traders may not compete directly with the parties to supply all end-users, it may be appropriate to exclude them from the relevant market for the purpose of calculating market shares. By excluding oil majors and traders, the OFT estimated that the parties' combined share of supply in Scotland is 57 per cent with an increment of around 16 per cent. However, the parties argued that, if the OFT were to exclude the volumes of oil supplied by oils majors and traders, it would also be appropriate to exclude those volumes that GB Oils achieves through sales to customers for whom the oil majors and traders compete. In particular, the parties provided examples of customers that they have lost to oil majors and traders in recent years. Therefore, the parties argued that, under these circumstances, their combined market share in the distribution

[5] Market shares in the area where the parties' activities overlap in Northern England were not available but the OFT believes that they would be comparable to those within Scotland.

of heating oils and transport fuels for which the oil majors do not compete is more likely to be in the region of 30-35 per cent.

40. Conversely, third parties indicated that the parties' combined market share in Scotland would be in the region of 60-70 per cent. However, these third parties did not provide the basis of their market share estimates. Nonetheless, consistent with this, the parties have the largest distribution network of depots in mainland Scotland.[6] In particular, based on evidence available to the OFT, the parties will have 31 depots post merger (Brogans had 13 depots pre-merger), with Highland Fuels following with 11 depots, Gleaner Oils with 10 depots, Johnston Oils with five depots and Johnstone Wallace Fuels with four depots.

41. Regardless of their precise combined market share, it is clear that the parties were the first and second largest independent distributors of heating oils and transport fuels in Scotland and Northern England in terms of both volume and number of distribution depots with the remaining distributors being relatively modest in size. Therefore, the merger might be expected to raise competition concerns. The OFT has therefore examined below whether the parties are as close competitors as—or closer than—implied by these shares and whether there are other actual and potential distributors that are capable of constraining the merged entity.

Closeness of competition

42. The majority of third parties stated that the parties compete closely in the distribution of heating oils and transport fuels. In particular, two third parties indicated that Brogans was a particularly aggressive competitor. In addition, third parties stated that the parties were closest competitors in terms of the volume they supply and the number of depots across Scotland, and that their scale of operations was much larger in comparison to smaller, local distributors.

43. The parties argued that they did not view themselves as each other's closest competitors. In particular, GB Oils contended that neither Brogans' relative size nor the distribution of its depots in Scotland and Northern England meant that it was a stronger competitor to GB Oils than was any

[6] The parties will also have the largest depot infrastructure in the area of overlap in Northern England.

other distributor. In addition, the parties argued that GB Oils had a different business profile to other distributors such as Brogans. For example, a significant proportion of its volume was achieved through supplies to large volume commercial customers whereas Brogans tended to achieve a much higher proportion of its sales to smaller customers. Furthermore, GB Oils provided some evidence on individual depots across Scotland showing that the proportion of its volumes attributable to commercial customers is significantly greater than the equivalent proportion for the nearest Brogans' depot. Finally GB Oils stated that it viewed the oil majors and traders as representing its major competitive constraint given its focus on large volume customers. By contrast, Brogans viewed smaller distributors as its main competitive threats. Consistent with this, evidence from one third party, who tendered a large contract in central Scotland, was that it did not consider that Brogans was of a sufficient scale to meet its needs.

44. Based on the evidence before the OFT, the parties are the largest two independent distributors of heating oils and transport fuels in Scotland and Northern England. A number of third parties viewed them as being close competitors. However, there is some evidence that the parties' business profiles differ to the extent that they tend to focus on different customer groups. There is also some third party evidence that they have not competed for some large-volume customers.

45. To explore this further, the OFT has examined below whether there are other actual and potential suppliers capable of providing a competitive constraint to the parties post-merger.

Alternative distributors

46. Although no single competitor will have a comparable geographic coverage of networks as the parties, evidence provided to the OFT indicates that there are a number of other distributors which can supply heating oils and transport fuels. Although there were mixed views on the price competitiveness of some local and regional distributors, the parties argue that they will continue to face strong competition from a number of other players with multiple depots and transportation infrastructure in Scotland and Northern England; in particular Gleaner Oils and Highland Fuels, but also Johnston Oils and Johnstone Wallace Fuels.

47. Furthermore, the parties submitted—and third parties agreed—that distributors generally have enough spare capacity in their existing infrastructure to expand their activities and therefore can respond to competitive opportunities at short notice. In addition, the costs of adding additional capacity simply involve acquiring tanker capacity which can be at a relatively low cost. In addition, the parties gave a number of examples where smaller distributors had expanded their delivery networks in recent years by operating more lorries or opening new depots.

Conclusion

48. Based on the evidence available to it, 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 Scotland and Northern England as a whole. In particular, the OFT does not consider that the parties were close competitors for large-volume contracts.

49. The parties will have the most extensive network of depots across Scotland and Northern England. However, they will continue to face constraint from other distributors, in particular Highland Fuels and Gleaner Oils who are capable of providing a competitive constraint to the parties post-merger. In addition, the merged firm will continue to face some further competitive constraint from numerous local and smaller regional distributors, and potentially also some constraint from the oil majors and traders for large volume customers.

Local Level

Introduction

50. There are several local areas across Scotland and Northern England where the parties' depots are situated either within each other's catchment area (as defined by a 30-50 mile radius around a depot) or, if not, where the parties' catchment areas substantially overlap.

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51. 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.[7] On this basis, in the majority of localities, customers would continue post-merger to have at least three alternative suppliers within the local area, at least one of whom is a distributor with multiple depot facilities.

52. However, the OFT retained some preliminary concerns regarding those overlaps containing customers for whom the parties may have been their closest suppliers or where fewer than three alternative suppliers would remain in the local area. Therefore, the OFT examined competition at a local level and whether there were – in these areas - alternative distributors, even outside the 30-mile supply radius that could provide a competitive constraint to the merged entity post-merger.

Local competition

53. 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' tankers. The parties submitted that the average supply radius for Brogans tankers is 250 km (over 150 miles). In particular, the parties stated that GB Oils high concentration of depots has been shaped by, among other things, their previous acquisitions and that this dense depot network is not replicated by other distributors. Furthermore, the parties stated that the presence or absence of a depot does not, in itself, indicate the constraint posed by a competitor on the parties. This is because the parties' depots only carry around two to three days stock, and a significant proportion of deliveries are made direct from the oil refineries or terminals.

54. Third party opinion was mixed regarding the appropriate catchment area of individual depots. However, one distributor argued that 50 miles was the maximum they would travel and two distributors considered that distance would be limited by how far they could travel in a day.

55. 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

[7] The OFT considered the impact of the merger within each local area where the parties' depots overlapped. However, since competition issues did not arise in any locality, other than the Western Isles, it is not necessary for each overlap to be presented in detail.

articulated vehicle could, to a certain extent, replicate the storage function carried out by a depot.

56. The parties argued that supplying customers cost effectively relies on the ability to establish a route of customers. Therefore, the viability of a route (sometimes called a ‘milk round’) does not depend on how far individual customers lie from each depot, but rather the incremental cost of supplying a customer is dependent on their proximity to the distribution route rather than the depot.

57. The OFT considered whether it was more difficult to establish a viable route in areas of sparse population. The OFT's investigation showed that deliveries may be less regular to such areas to ensure enough customer orders are present to make the ‘milk round’ economical. The parties argued that no concerns would arise in these areas. They submitted details of several customer buying groups and suggested that, with an average domestic purchase of around 600-700 litres, a tanker of 15,000 litres would only require a collection of 20-30 domestic customers to justify a full tanker. Based on its investigation, the OFT considers that in each of the catchment areas considered, there were sufficient alternatives to constrain the parties post merger.

Alternative distributors

58. The parties submitted that the OFT should not distinguish between the constraint posed by smaller distributors to that of 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 that smaller distributors operate from a lower cost base. Consequently, the parties argued that smaller distributors are able to compete on price with larger players. In addition, the parties submitted some evidence of losing business to rival distributors, both large and small.

59. 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.

60. 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, as well as recruiting sales reps or drivers employed by competitors already in an area. They highlighted one example of a competitor who had recently targeted business in a new area by deploying a tanker in a permanent parking space.[8] The parties also described specific examples of competitors targeting business in new areas via deploying marketing materials (including mail shots) and using sales representative's to target new areas.

61. Third parties generally agreed that it was possible for existing distributors to supply customers in other geographic areas and provided a number of examples. In particular, third party enquiries highlighted two specific expansions of activity on the mainland which have occurred since the merger completed.

62. The parties suggest that establishing a customer base is aided by the very low switching costs that exist in this market. Many customers purchase on a spot basis and can receive quotes almost instantaneously from several suppliers provided they serve that local area.

Conclusion

63. On the basis of the above, the OFT concludes 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 mainland Scotland and Northern England. In particular, the OFT believes that across each locality where the parties have depot facilities, a sufficient number of competing distributors will remain to provide a constraint on the parties post-merger—including competitors from outside the locality.

Western Isles

Unilateral effects

64. The parties are the only two distributors of heating oils and transport fuels in the Western Isles. The merger is therefore to monopoly. Responses from third parties indicated that distribution to the Western Isles is logistically more difficult than on the mainland. Indeed, most other distributors

[8] Although one third party considered that petrol (at least) should not be stored outside of a depot overnight for safety purposes.

indicated that they would not supply the Western isles because of the cost of doing so. Therefore, the OFT believes that it may be the case that, once competition between the parties is removed post-merger, the merged entity may have the incentive and ability to increase prices and/or reduce service levels in the Western Isles.

65. Conversely, the parties argued that if the Western Isles were to be seen as a separate market, the merger should not give rise to any competition concern. In particular, the parties argued that—although Brogans has had some success in winning business in Lewis (gaining approximately 10 per cent of the market on the Western Isles since its entry in 2008)—it provides a relatively limited competitive constraint on GB Oils.

66. To corroborate this point, the parties provided the OFT with pricing data on heating oil and transport fuel in the Western Isles, which appears to indicate that GB Oils' prices did not fall after Brogans entered (even controlling for movements in the wholesale fuel/oil price). GB Oils argued that because it was already pricing competitively (being constrained by distributors on the mainland) it did not need to react to Brogans' entry and there was no change in its price. However, given the complexity of the algorithm used by GB Oils to set baseline daily prices[9]—and its practice of negotiating delivered prices—the OFT could not preclude that the apparent lack of an impact on GB Oils' prices from Brogans' entry was an artefact of the data analysed.[10]

67. In this regard, the OFT received a large number of customer concerns regarding the distribution of heating oils and transport fuels in the Western Isles. These concerns stated that after Brogans began distributing heating

[9]The parties submitted that '[t]he purchase price is linked to Platts' price plus a margin, but is calculated on the basis of an average price for the month in which the oil is delivered. This monthly average price is not known until a few days into the following month. When assessing its cost of supplies for the purposes of determining its selling price, GB Oils is required to assess the cost of fuel already stored in its terminal and the likely future cost of supplies to its marine terminal. As regards existing stocks, if it purchased this fuel in the previous month, this price should be known (albeit that it would only be known after the first few days of the month have passed); if the fuel has been purchased in the same month in which the cost calculation is being made, the cost of fuel may not be known. Therefore, when setting its selling prices, GB Oils has to engage in a degree of speculation as to Platts' price developments.' It was not possible for the OFT's own statistical analysis to adequately control for this complexity, given a lack of information on GB Oils historical fuel stocks and on its expectations of movements in the Platt's price.

[10]At the Issues Meeting, the parties indicated that their own statistical analysis had also failed to adequately control for this 'noise' in the data.

oils and transport fuels in the Western Isles in 2008, prices had fallen. Customers believed that this was because Brogans' prices had constrained GB Oils' prices. The data provided to the OFT by the parties discussed in the preceding paragraph corroborated this point to a certain extent; in particular, for a sample of contemporaneous transactions identified by the OFT (that is, days when Brogans and GB Oils both made comparable sales), Brogans' average per litre price for petrol was consistently cheaper than GB Oils (even allowing for differences in the volumes sold). In addition, for the first six months that Brogans delivered gas oil, it was consistently cheaper than GB Oils. In addition, the majority of customers (not just those with concerns) were unable to name any other distributors that they considered as an alternative to the parties.

68. On the basis of the above, the OFT considers that the merger raises competition concerns in relation to the distribution of heating oils and transport fuels in Western Isles. The OFT has therefore examined below whether there are other potential suppliers capable of constraining the merged entity in Western Isles.

Alternative distributors

69. The parties argued that there are no major barriers to entry to oil distribution, as the costs of entry are low, there are no requirements for the acquisition of know-how or intellectual property rights and there is no requirement to establish a strong brand. The parties identified the only barriers to new entry as the costs of tankers, premises, obtaining supplies and availability of credit. The parties further argued that barriers to expansion are low and gave examples of oil distributors who had expanded their services in Scotland and the Islands in recent years.

70. The parties stated that in the Western Isles, GB Oils was pricing competitively prior to Brogans' entry as GB Oils was (and will continue to be) constrained by the threat of entry from suppliers in the mainland. GB Oils argued that there was no reason why competing suppliers in the mainland could not duplicate the position which Brogans has established on the Western Isles, as competing distributors could utilise the RET scheme (see paragraph 25) to enter the Western Isles. In addition, the parties stated that the lack of a local depot would not prevent third parties from imposing a strong competitive constraint on the parties. In particular, the parties stated that Brogans began deliveries on the Western Isles without a

depot and only leased its depot in late 2009. Finally, the parties argued that Simpson Oils (which has depots on the mainland in Wick and Scrabster) had recently commenced deliveries to the Western Isles to a number of customers.

71. The majority of third parties stated that they did not have a maximum delivery distance for large (that is, full tank) deliveries. However, they indicated that it would be uneconomical to make small deliveries over long distances. In particular, third parties stated that they were not actively exploring the possibility of distributing oil in Western Isles and stated that, in any event, it would not be profitable for any new entrant to deliver to a small number of customers in Western Isles from the mainland.

72. Evidence available to the OFT indicates that [ ] at prices cheaper than GB Oils. The OFT understands that [ ]. In addition, the OFT understands that [ ]. Furthermore, [ ] indicated that it was not possible to get contractual commitments from small customers, as they do not normally purchase oil via contracts. [ ] considered that this would be likely to make any further new entry in Western Isles small in scale, and reliant upon the establishment of a customer base.

73. The question for the OFT is whether entry into the distribution of heating oils and transport fuels in the Western Isles is likely, timely and sufficient enough to deter to any attempt by the parties to raise prices or reduce service quality. In this regard, the OFT notes that [ ] and therefore it is somewhat uncertain. As indicated by [ ], it is unclear whether, in future, it will be able to establish a customer base and to supply smaller customers on the island. Therefore, notwithstanding [ ], the OFT cannot be sufficiently confident that further entry on the Western Isles is likely, timely or sufficient to constrain GB Oils post merger, in particular for certain customer segments (that is, smaller customers).

74. On the basis of the above, the OFT concludes that there is a realistic prospect of a substantial lessening of competition in the distribution of heating oils and transport fuels in Western Isles.

THIRD PARTY VIEWS

75. The OFT received comments and views about the merger from a large number of third parties, including competitors, customers of the merging parties and a number of MPs and MSPs.

76. The majority of comments included complaints regarding the likely effects of the merger in Western Isles. These are referred to above where relevant. Many complainants were concerned that the removal of Brogans as an independent competitor would have a detrimental impact on their ability to obtain competitive prices for heating oil and transport fuels in Western Isles.

77. The OFT also considered carefully some concerns that it received regarding the impact of the merger in Scotland and some local areas. These concerns have been dealt with above where relevant.

ASSESSMENT

78. The parties overlap in the distribution of heating oils and transport fuels and the operation of fuel card services in Scotland and Northern England.

79. On the narrowest plausible product market definition of the national operation of fuel card services, the parties' combined share in the UK would be no more than five per cent. On this basis, the OFT did not further investigate fuel card services.

80. In relation to the distribution of heating oils and transport fuels, the OFT considered it appropriate to aggregate individual product markets for types of heating oil and transport fuel into a single product market on the basis of supply-side considerations, and to assess the merger on this basis. In addition, the OFT examined the impact of the merger at both a national level, where the parties supply national account customers and local level. In doing so, the OFT gave particular consideration to the Western Isles, where it received a large number of complaints.

81. In Scotland and Northern England, the parties are the two largest independent distributors of heating oils and transport fuels by number of depots and in terms of volumes supplied. However, the OFT is of the view

that the parties may not have been close competitors for the largest contracts by volume. For national customer contracts, where a distribution network is a pre-requisite, there are at least four distributors with significant depot and distribution infrastructure who are capable of providing a competitive constraint to the parties post-merger, in particular Highland Fuels and Gleaner Oils, but also to a lesser extent smaller distributors such as Johnston Oils and Johnstone Wallace Fuels. The merged party may also face some competitive constraint from oil majors and traders as regards large volume customers. 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 across Scotland and Northern England as a whole.

82. At a local level, there are several areas across Scotland and Northern England where the parties' depots are situated either within each other's catchment area (as defined by a 30-50 mile radius around a depot) or, if not, where their catchment areas overlap. In the majority of localities, customers would continue post-merger to have at least three alternative suppliers, at least one of whom is a distributor with multiple depot facilities. For a minority of localities, however, the parties may have been closest competitors and/or faced fewer than three other competitors.

83. Based on the evidence available to the OFT, across each local area where the parties have depot facilities, a sufficient number of distributors will remain to provide a constraint on the parties post-merger. In addition, the OFT is of the view that the presence of a depot may not be a pre-requisite for effective competition, and that the parties will be constrained by competitors from neighbouring regions. Therefore, the OFT concluded that the merger does not raise any competition concerns in the distribution of heating oils and transport fuels to all customer types across each local area other than the Western Isles where the parties have a depot.

84. Finally, in Western Isles, the parties are the only two distributors of heating oils and transport fuels. 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. The OFT examined pricing evidence provided by the parties but given the complexity of the algorithm used by GB Oils to set baseline daily prices and its practice of negotiating delivered prices, the OFT could not preclude that the apparent lack of an impact on GB Oils' prices from

Brogans' entry was an artefact of the data analysed and therefore it could not rule out the possibility that GB Oils' operation in the Western Isles had not been constrained by Brogans' entry. In addition, despite the evidence of one distributor supplying oil from mainland Scotland to [ ] on the Western Isles, further new entry was not likely, timely and sufficient enough to constrain the parties post-merger, in particular for certain customer segments (that is, smaller customers).

85. On this basis, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

UNDERTAKINGS IN LIEU

Introduction

86. Where the duty to make a reference under section 22(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.

87. The OFT's *Mergers Substantive Assessment Guidance* states that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation' (paragraph 8.3).

88. GB Oils indicated that in order to remedy any competition concerns identified by the OFT, and to avoid a reference to the CC, it would be prepared to offer undertakings in lieu. Specifically, it offered to divest Brogans' oil distribution business on the Isle of Lewis in the Western Isles. In addition, GB Oils offered, at the option of the purchaser of the Brogans oil distribution business on the Isle of Lewis, a throughput arrangement in respect of GB Oils marine terminal on the Isle of Lewis, for a minimum of five years or such shorter minimum period as the potential purchaser would be prepared to accept.

89. The extent to which GB Oils' proposed divestment package is considered by the OFT to be capable of 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, is addressed below.

Divestment(s) – Brogans' oil distribution business on Western Isles

90. The undertakings offered by GB Oils include the divestment of the following assets:

    a. the two oil tankers used by Brogans on the Isle of Lewis

    b. [ ]

    c. the self-bonded storage tanks which Brogans owns on the Isle of Lewis, and

    d. the customer records and any customer contracts of the Brogans business relating to the customers in the Western Isles.

91. The parties stated that GB Oils would not be in a position to transfer the lease over Brogans' Stornoway site where its depot was located because it had recently been terminated. Indeed, the parties stated that Brogans is under the obligation under the terms of the lease to remove its depot infrastructure by 30 June 2010.

92. However, the parties stated that the fact that they were not able to divest the depot site would not represent a material barrier to the purchaser establishing an alternative depot on the Isle of Lewis, in particular in the light of the general availability of suitable land on the island.

Throughput arrangement

93. GB Oils would also offer to a potential purchaser of the assets outlined above an option of a throughput arrangement for a minimum period of five years or such shorter minimum period as the purchaser would be prepared to accept, at its marine terminal on the Isle of Lewis. Specifically, the purchaser would purchase the fuel from a third party supplier, who would deliver the fuel to GB Oils' marine terminal and GB Oils would provide

storage and throughput service to the purchaser. The purchaser would draw the oil from the terminal and would pay a throughput fixed fee to GB Oils. Under this arrangement, GB Oils would not be a party or involved in the negotiation of the fuel supply contract with the oil supplier.

Conclusion

94. The OFT considers that the undertakings offered in respect of the divestment of Brogans' oil distribution business in Western Isles is capable of clearly capable of addressing the competition concerns identified. At the same time, the OFT is conscious that GB Oils is not able to transfer the site on which Brogans operated such that there is no guarantee that the new purchaser will have access to a depot in the Western Isles. Given the importance of a physical location to the competitive dynamic (see paragraphs 32 – 34), the OFT considers that it is necessary to provide for some form of alternative arrangement in the event that the purchaser does not succeed in obtaining Brogan's existing (or an alternative) depot site in the Western Isles.

95. The OFT believes that a throughput agreement may be acceptable if terms were able to be agreed between GB Oils and the new purchaser that enabled them to compete independently of each other. Furthermore, the terms of any such throughput agreement would need to be approved by the OFT before it was concluded.

Need of an up-front buyer

96. 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.[11]

97. 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.

[11] 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.

98. In this case, the OFT considered there to be a reasonably small number of potential purchasers that would be capable of viably distributing heating oils and transport fuels in the Western Isles in such a way as to restore pre-merger competitive levels. Perhaps more importantly, the OFT is mindful of the fact that Brogans would have to vacate the depot on Stornoway by the end of June following the notice served by the landlord to terminate the lease on the site, with the result that:

- to be acceptable as a suitable purchaser, any acquirer of the divestment business would need either to: (a) agree a new lease with the landlord of the Brogans site, or (b) secure a suitable new site for a depot, or (c) agree the terms of a throughput agreement with GB Oils and

- it is difficult for the OFT to ascertain with sufficient confidence whether such a site for a depot exists or to pre-determine, in the absence of the purchaser in question, suitable terms for a throughput agreement with GB Oils.

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

Conclusion on undertakings in lieu

100. 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

101. The OFT's duty to refer the completed acquisition by GB Oils Limited of Brogan Holdings Limited to the Competition Commission pursuant to section 22 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.

ENDNOTE

1. Subsequent to the Decision, GB Oils requested that the OFT clarify as regards paragraph 67 that GB Oils had submitted that its prices to customers in the Western Isles fell around the time of Brogans' entry into the Western Isles in late 2008 as a result of a significant global drop in oil prices at that time (GB Oils contended that these prices were reflected in the Platts' prices which form the base price for the oil purchasing costs of GB Oils). GB Oils also requested clarification as regards paragraphs 66 and 67 that it had argued that the ability of Brogans to offer lower prices on particular occasions was due to the different purchasing dynamics of GB Oils compared with Brogans (as explained in footnote 9).'