

Anticipated acquisition by Cavendish Square Partners (General Partner) Limited of a controlling interest in each of Lakeside 1 Limited (Keepmoat) and Apollo Group Holdings Limited (Apollo)

ME/5213/11 and ME/5291/11

The OFT's decision on reference under section 33(1) given on 24 November 2011. Full text of decision published 16 December 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. Cavendish Square Partners (General Partner) Limited ('**Cavendish**') is the general partner of the investment fund, Cavendish Square Partners Limited Partnership (the '**Cavendish Fund**'). [].
2. Lakeside 1 Limited ('**Keepmoat**') builds and refurbishes houses predominately in the social housing sector¹ in the North of England and the Midlands. It also has a division which builds and sells housing on the open market. In the last financial year, Keepmoat's UK turnover was £677 million.
3. Apollo Group Holdings Limited ('**Apollo**') is a property services company predominately operating in the social housing sector. Apollo's focus is on building, maintaining and renewing properties, particularly in London and the South East. In the last financial year, Apollo's UK turnover was £367 million.

¹ Social housing (sometimes, also referred to as 'public housing') is housing that is let at affordable rents and on a secure basis to people in housing need.

4. Both Keepmoat and Apollo have been part of the same portfolio of investments, currently the Cavendish Fund, since 2007.² Cavendish has a 16.5 per cent shareholding in Keepmoat and a 19.9 per cent shareholding in Apollo. Cavendish also has a minority stake in another service provider in the construction industry, Rydon Group Limited ('Rydon').³ Rydon supplies construction and maintenance services, to the public and private sector.

TRANSACTIONS

5. The transactions were announced on 22 July 2011. It is envisaged that Cavendish will set up a special purpose vehicle which will acquire both Keepmoat and Apollo. Cavendish will acquire a controlling interest in each of Keepmoat and Apollo [].
6. The administrative deadline for the Office of Fair Trading (OFT) to make a decision in respect of both acquisitions is 24 November 2011.

RATIONALE FOR THE MERGERS

7. The parties consider that the transactions will create a group with enhanced scale and financial strength which will enable the sharing of resources and expertise to reinforce nationwide service delivery. In particular, Apollo will help to strengthen Keepmoat's maintenance capabilities and Keepmoat will boost Apollo's new build offering.

JURISDICTION

8. A relevant merger situation arises when two or more enterprises cease to be distinct and either the UK turnover test or the share of supply test set out in section 23 of the Enterprise Act 2002 (the Act) is met. The parties raised two points in relation to the question of jurisdiction, namely:
 - (a) that the OFT should not exercise its discretion to treat the acquisition of the controlling interest as a relevant merger situation pursuant to section 26(4)(a) of the Act given that Cavendish already holds a level

² The Cavendish Fund owns the portfolio of private equity investments which was previously held by Bank of Scotland Integrated Finance ('BoSIF'), a business unit of the Lloyds Banking Group (and prior to 2009, HBOS plc). In 2010, the BoSIF portfolio was sold by Lloyds Banking Group to the Cavendish Fund.

³ Cavendish has 19.99 per cent of the voting rights in Rydon.

of control in each of Keepmoat and Apollo and

- (b) in the event that the OFT does choose to treat the increase in the level of control as a relevant merger situation, that the transactions constitute a single relevant merger situation.

Each of these points is examined below.

Exercise of OFT discretion under section 26(4) of the Act

9. The OFT considered carefully the parties' argument that the OFT should not choose⁴ to treat the acquisitions as relevant merger situations given that Cavendish was already a minority shareholder in each of Keepmoat and Apollo and that the degree of influence that Cavendish enjoyed was [].⁵
10. However, the OFT has identified several arguments in support of it exercising its discretion to review the two mergers in this case. First, the OFT notes that it has not previously had an opportunity to review the separate shareholdings of Cavendish in each of Keepmoat and Apollo and considers that it is important to undertake a review at this stage. Whilst the OFT has not needed to conclude on the level of control Cavendish currently has over Keepmoat and Apollo, it considers that the acquisition by Cavendish of a controlling interest in each firm represents an increase in control from the pre-merger situation.
11. Secondly, the mergers are expected to result in a change to the organisational structure of Keepmoat and Apollo. Currently, both businesses operate as separate entities (albeit with a common minority shareholder) but the OFT notes that, post merger, the intention is to consolidate the two businesses into a single group competing on a national as well as a regional basis. Given the stated rationale for the mergers

⁴ Section 26(4) of the Act provides that 'For the purposes of [determining whether two enterprises have ceased to be distinct], in so far as it relates to bringing two or more enterprises under common control, a person or group of persons **may** be treated as bringing an enterprise under his or their control if (a) being already able to control or materially to influence the policy of the person carrying on the enterprise, that person or group of persons acquires a controlling interest in the enterprise or, in the case of an enterprise carried on by a body corporate, acquires a controlling interest in that body corporate' (emphasis added).

⁵ The parties stated that '[]'.

outlined above, the OFT considers that it is important to review the potential competitive impact of each transaction.

12. Finally, the OFT notes that there have been a number of instances where the OFT has exercised its discretion to review a merger incorporating a change from material influence or de facto control to full control⁶ and it does not consider that the two mergers in this instance should not be examined, contrary to the OFT's position in those cases.
13. On the basis of the reasons given above, the OFT has exercised its discretion to treat the acquisitions of the controlling interest as a relevant merger situation pursuant to section 26(4)(a) of the Act.

One or two relevant merger situations?

14. The parties submit that the acquisition of a controlling interest in each of Keepmoat and Apollo by Cavendish qualifies as a single relevant merger situation. In support of this view, the parties note that Cavendish is at present a common shareholder between Keepmoat and Apollo and submit that, []. The parties put forward a number of arguments that Cavendish [].
15. The parties also consider that as the transactions are contractually inter-conditional and that Cavendish will acquire a controlling interest in each of Keepmoat and Apollo simultaneously, this indicates that the acquisitions represent a single relevant merger situation. The parties also submit that as the OFT's substantive assessment will be captured in a single investigation, this also supports their view. Finally, the parties refer to the European Commission's Consolidated Jurisdictional Notice⁷ which requires that a single concentration is 'unitary in nature'. The Commission stipulates that 'the economic reality underlying the transactions is to be identified and thus the economic aim pursued by the parties.' In this case, the parties argue that the economic reality of the transactions is that a single concentration (or single relevant merger situation) arises and that the European Commission, as a result of the contractual inter-conditionality,

⁶ See, for example, 'Anticipated acquisition by Guoco Group Ltd of Rank Group plc', OFT, 27 June 2011 and 'Anticipated acquisition by Guardian Media Group of Trader Media Group', OFT, 29 September 2003.

⁷ Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C 95/01).

would consider them as a single concentration were they to have a Community dimension.

16. The OFT has carefully considered the parties' arguments in this case. However, it notes that both Keepmoat and Apollo have a broad range of shareholders of varying sizes and that, other than Cavendish which has a shareholding of below 20 per cent in each firm, there is no common shareholder between the two firms. On this basis the OFT considers that the vendors in relation to each business are effectively different. The OFT considers that ownership of the target businesses is the key factor in determining whether these transactions represent a single or dual relevant merger situations.⁸ Therefore, given that Keepmoat and Apollo are separately owned entities prior to their acquisition by Cavendish and are not under common control (other than by Cavendish itself), the acquisition of each of them by Cavendish is potentially a relevant merger situation for the purposes of the Act.
17. With regard to the timing considerations, the OFT does not consider the inter-conditionality of the transactions to be relevant in this case due to the vendor being different in each transaction. As a result, the OFT does not consider that these acquisitions are part of the same 'arrangements or transactions' and hence do not represent a single relevant merger situation. Whilst the OFT investigation is captured in a single decision for the sake of convenience, the jurisdictional assessment remains that there are two separate transactions.
18. Finally, the OFT notes the European approach to this and similar merger situations as set out in its Notice. However, the OFT is not bound by the Commission's Notice and notes that the UK legislative framework is based on different considerations to those of the EU Merger Regulation. The OFT is therefore not persuaded that, in this instance, the acquisition of a controlling interest in each of Keepmoat and Apollo by Cavendish qualifies as a single relevant merger situation.

⁸ See paragraph 6 of ME/4664/10 'Completed acquisition by MWUK Holding Company Limited of Dimensions Clothing Limited' and Completed acquisition by MWUK Holding Company Limited of certain assets of Alexandra plc (in administration)', OFT, 2 November 2010.

Acquisition of Keepmoat

19. As a result of this transaction Cavendish will acquire a controlling interest in Keepmoat. The UK turnover of Keepmoat 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

Acquisition of Apollo

20. As a result of this transaction Cavendish will acquire a controlling interest in Apollo. The UK turnover of Apollo 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

COUNTERFACTUAL

21. Due to the fact that Cavendish will acquire Keepmoat and Apollo in parallel, the OFT has considered the appropriate counterfactual against which to assess each transaction.
22. As set out in the OFT's guidance,⁹ 'the Authorities may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction). For the OFT, the question is, as always, whether the transaction under review creates the realistic prospect of a substantial lessening of competition (SLC), and it is likely to consider whether the statutory test would be met whether or not the parallel transaction proceeds (unless the parallel transaction can clearly be ruled out as too speculative).'
23. In this case, it is clear that the acquisition of each of the two businesses is not speculative given that it has been notified to the OFT. The OFT considers that the relevant question is whether, given the proposed acquisition of a controlling interest by Cavendish in Keepmoat, the addition

⁹ See Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.25 and 4.3.26.

of a controlling interest in Apollo creates a realistic prospect of a substantial lessening of competition and similarly whether, given the proposed acquisition of a controlling interest by Cavendish in Apollo, the addition of a controlling interest in Keepmoat creates a realistic prospect of a substantial lessening of competition.

24. In determining the answer to this question for each relevant merger situation, the OFT assessed the competitive constraints that the merged entity would be likely to face following the mergers (as it would in assessing an individual merger).

MARKET DEFINITION

25. Keepmoat and Apollo overlap in the provision of services in the social housing sector in the UK. The bulk of their activities are in the repair, maintenance and improvement ('**RMI**') of properties owned by public authorities, predominately social housing stock and, to a more limited extent, in the education sector. Both companies also build new social housing (properties constructed for public authorities for subsequent rent to tenants).
26. It is estimated that in 2010 the total spend on public sector housing in the UK (excluding Northern Ireland) was approximately £15-16 billion (of which broadly 70 per cent was spent on RMI and 30 per cent on New Build Social Housing).¹⁰ Currently, eight million people in the UK live in social housing, with a further 1.8 million households on social housing waiting lists.¹¹
27. In the UK, social housing is generally provided by local authorities ('**LAs**'), registered social landlords ('**RSLs**') and other publicly funded organisations. LAs and RSLs are Keepmoat's and Apollo's main customers. The parties estimate that approximately 60 per cent of total RMI is outsourced and contracts are awarded to external contractors following tendering procedures, subject to public procurement rules.

¹⁰ Source: The parties (PwC, referring to Hewes & Associate, ONS, CLG, TSA and PwC interviews and analysis).

¹¹ Department for Communities and Local Government consultation 'Local decisions: a fairer future for social housing' (November 2010), paragraphs 1.1 and 1.4.

Product and geographic scope

28. The parties note that the OFT, in its decision relating to bid rigging in the construction industry ('**the Construction Decision**'),¹² concluded that separate relevant product markets existed for private housing and public housing services. The parties submitted that these represented appropriate frames of reference but for completeness also provided shares of supply separately for New Build Housing and RMI in the social housing sector.
29. For the purposes of assessing both transactions, the OFT has considered public housing services as a separate frame of reference from private housing services. On a cautious basis, it has also considered New Build Housing separately from RMI.
30. The parties submitted that most construction companies set their prices mainly by reference to regional or local conditions. In its Construction Decision, the OFT found that markets are likely to be regional. The OFT has therefore considered these transactions on a regional basis. Due to the parties' stated rationale for the mergers, that is, to reinforce its nationwide service delivery, the OFT has also considered the transactions at a national level. Given that the mergers do not raise competition concerns, however, it has not been necessary to conclude on the precise product or geographic scope.

HORIZONTAL ISSUES

UNILATERAL EFFECTS

Shares of supply

31. The parties provided share of supply data for Keepmoat and Apollo for New Build Housing and RMI on a regional and national basis for the financial year 2010/11.

¹² See: Decision No. CA98/02/2009 Bid rigging in the construction industry in England 21 September 2009, www.offt.gov.uk/news-and-updates/press/2009/114-09 and <http://www.offt.gov.uk/news-and-updates/press/2009/135-09>.

32. Post merger, the parties will have an estimated combined share of supply of [0-10] per cent at a national level, with a minimal increment in the supply of New Build Social Housing. Keepmoat and Apollo overlap at a regional level in the East Midlands and East of England only. The parties' combined share of supply in these areas is below [0-10] per cent.
33. With respect to the supply of RMI, the parties will have an estimated combined share of supply of [0-10] per cent at a national level. The parties overlap in the supply of RMI in a number of regions but the overlap is limited. For example, Keepmoat has an estimated share of supply of [0-10] per cent in the North East and [10-20] per cent in Yorkshire and Humberside but Apollo only has a limited presence with a share of supply of less than [0-five] per cent in each region. Similarly, in those regions where Apollo has a stronger presence, for example in London where it is has an estimated share of supply of [0-10] per cent, Keepmoat is not present.
34. Rydon is mainly active in the South West and South East of England; Rydon has limited activities in the London area therefore the overlap with Apollo is minimal with an estimated combined share of supply of less than [0-10] per cent in the South East region; there is no overlap with Keepmoat.
35. The OFT notes that no material third party concerns were raised regarding the transactions. Given the limited increment resulting from the transactions, the OFT does not consider the shares of supply to point to prima facie competition concerns. Nevertheless, the OFT has, on a cautious basis, gone on to consider the closeness of competition between the parties.

Closeness of competition

36. Third parties do not consider the parties to be close competitors due to their different geographical reach. The OFT also notes the different mix of New Build Housing and RMI activities between Keepmoat and Apollo. Apollo's activities are concentrated in the RMI sector whereas Keepmoat has a much stronger presence in the New Build Social Housing sector.

37. The parties provided details of the tenders for framework agreements that Keepmoat and Apollo have bid for in the past 12 months. Of the [60-70] and [50-60] tenders submitted by Keepmoat and Apollo respectively, they overlapped in [10-20] cases and were successful in [0-10] of these. This represents less than [0-10] per cent of all of the framework tenders submitted by either Keepmoat or Apollo in the last 12 months.
38. The parties identified ten national competitors¹³ and at least three regional competitors in each region. Customers also identified a range of suppliers that had tendered for and won work in their local area. The OFT considers that the existence of other strong suppliers in the market should act as a sufficient competitive constraint on the parties post merger.

Conclusion

39. Given the limited increment at both a national and regional level resulting from the transactions and the existence of a significant number of other suppliers in the market, the OFT does not consider there to be a realistic prospect of a substantial lessening of competition on the basis of unilateral effects in the supply of New Build Housing or RMI services in the social housing sector at either a national or regional level.

CO-ORDINATED EFFECTS

40. The OFT notes that with regard to the Construction Decision, there is evidence of pre-existing co-ordination in this sector and that both Keepmoat and Apollo were parties in the investigation.
41. The parties submit that the transactions do not give rise to a risk of co-ordinated effects on the basis that the increment resulting from the mergers is minimal. Nevertheless, due to evidence of pre-existing co-ordination, the OFT has considered whether the mergers increase the likelihood of co-ordination in the supply of RMI or New Build in the social housing sector. The OFT considers that three conditions must be satisfied for co-ordination to be possible.¹⁴ First, firms need to be able to reach and maintain the terms of co-ordination. Secondly, co-ordination needs to be

¹³ Key competitors identified by the parties were Kier, Lovell/Morgan Sindall, Wates, Mears, Mitie, Morrison, Wilmott Dixon, Interserve, Balfour Beatty, ISG Jackson.

¹⁴ See Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.5.9.

internally sustainable. And thirdly, co-ordination needs to be externally sustainable.

42. In terms of ability to reach co-ordination, the OFT notes that given the very limited geographical overlap of the parties, the transactions do not reduce the number of firms that can potentially co-ordinate in a particular region. For this reason, the OFT considers that the transactions will not have any effect on the ability of firms to reach a co-ordinated outcome.
43. Co-ordination will only be sustainable where the additional profit from co-ordination is sufficiently high, and there is an effective mechanism to punish deviation. All else being equal, the greater the number of firms, the larger the profit that deviation produces and the less sustainable co-ordination becomes. Therefore, as the mergers are not expected to reduce the number of firms in a region, the OFT does not consider that the mergers increase the ability of firms to maintain co-ordination.
44. Finally, the OFT notes that third parties do not consider that the mergers will reduce their negotiating strength. The OFT therefore considers that the mergers will not have any material impact on the external competitive constraints that firms currently face pre-merger.
45. The OFT notes that no concerns were expressed by third parties about the impact of the mergers on the likelihood of co-ordination. On the evidence available therefore, the OFT does not consider that these mergers will strengthen the conditions for co-ordinated behaviour.

BARRIERS TO ENTRY AND EXPANSION

46. The parties submitted that they have independently sought to expand their geographical reach by submitting bids to tenders in new geographic areas including the South West, Wales and Scotland but that []. The OFT notes that one competitor commented that barriers to entry in new regions are relatively high, including the time and resources required to establish a base, building customer awareness and ensuring a reliable supply chain.
47. Given the competitive assessment, it has not been necessary to conclude on the extent of any entry barriers.

BUYER POWER

48. When LAs and RSLs require RMI work to be done on their estates, they can either choose to keep this work in-house or outsource to an independent third party such as Keepmoat or Apollo. The parties argue that the threat of (potential) customers to keep RMI services in-house provides a significant constraint on the exercise of market power by a service provider in the social housing sector. The OFT notes that LA customers who responded during the investigation considered that the tender process ensured they received value for money, not just in terms of lower prices but also in terms of delivery and service.
49. The OFT considers that LAs may have a degree of buyer power when negotiating with third parties in the supply of services to the social housing sector. However, given that no competitive concerns arise as a result of the mergers, it has not been necessary for the OFT to conclude on buyer power.

VERTICAL ISSUES

50. Cavendish also has interests in four suppliers to the construction industry, namely:
- Gradus Limited, a designer and manufacturer of contract interior building products
 - Polypipe Limited, a manufacturer of plastic piping systems
 - Securistyle Limited, a supplier of hinges, handles and other accessories for window systems and doors and
 - WH Malcolm Limited, a provider of civil engineering and groundwork services.
51. The parties submit that these suppliers are not significant in terms of scale relative to the size of the overall construction sector including the public housing sector and that construction firms will deal with numerous suppliers. Therefore, the parties submit that any upstream supplier in which Cavendish has a stake is unable to have any real impact on the business activities of downstream rivals of the combined entity. The OFT notes that Cavendish does not have more than 20 per cent of the voting rights in any of the named suppliers above.

52. The OFT notes that no concerns have been expressed by third parties in relation to possible foreclosure resulting from the transactions. On the evidence available, the OFT does not consider there to be a realistic prospect of a substantial lessening of competition arising as a result of either input foreclosure to downstream competitors of the merged entity or customer foreclosure of suppliers to the construction industry.

THIRD PARTY VIEWS

53. The OFT received comments from customers, competitors and a number of trade bodies, none of which raised any material concerns regarding the mergers.

ASSESSMENT

54. The OFT considers that the acquisition by Cavendish of a controlling interest in Keepmoat and Apollo will represent two separate relevant merger situations and has assessed each merger on the basis of the change in control resulting from each transaction.
55. The parties overlap in the provision of RMI and New Build services to the social housing sector. On a regional (and national) basis the increment resulting from the mergers is minimal. The parties are not considered to be close competitors due to their different geographical reach. The OFT also notes the parties' different mix of activities; Apollo's activities are concentrated in the RMI sector whereas Keepmoat has a much stronger presence in the New Build Social Housing sector.
56. The existence of other strong suppliers in the market at both a national and regional level is expected to continue to act as a sufficient competitive constraint on the parties post merger.
57. The OFT does not consider that the transactions will strengthen the conditions for co-ordination. Given the limited geographical overlap resulting from the mergers, there will be no reduction in the number of firms that can co-ordinate within a region. Third party responses also indicated that LAs consider that they have a degree of buyer power and that this will not be reduced as a result of the mergers.

58. The OFT notes that no material third party concerns were raised regarding the transactions.

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

DECISION

60. Neither of these mergers will therefore be referred to the Competition Commission under section 33(1) of the Act.