

Anticipated acquisition of Quest End Computer Services Limited, Quest Systems Development Limited and Cywood Management Limited by MacDonald, Dettwiler and Associates Limited

The OFT's decision on reference under section 33(1) given on 14 February 2007. Full text of decision published 7 March 2007.

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**Please note that the square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.**

#### **PARTIES**

1. **MacDonald Dettwiler and Associates Limited (MDA)** is a publicly traded Canadian company listed on the Toronto Stock Exchange. It is the ultimate holding company of a UK registered private limited company of the same name, (which this decision refers to as MDA UK) which acts as a holding company for a number of operating companies including xit2 Limited, its wholly owned subsidiary.
2. **xit2 Limited (xit2)** designs, builds and operates three business to business web based applications to enable parties involved in UK property transactions to optimize the management of outsourced non-core processes, via a proprietary software platform. These are: The Valuation Exchange (VEx); The Repossession Exchange; and The Conveyancing Portal. In addition, xit2 provides professional software design and development services to third parties in the financial services industry to improve and automate their business processes, particularly in the areas of case management and tracking.
3. **Quest Associates (Quest)** is the trading name of three separate UK registered private limited companies which work together to provide Quest's Property Valuation processing system. These companies are:

Quest End Computer Services Limited (Quest End), Quest Systems Development Limited (Quest Systems) and Cywood Management Limited (Cywood). Quest End provides an electronic network, which connects banks, building societies, mortgage brokers, and packagers, panel managers and valuers for the delivery of valuations on properties which are the subject of loan applications. Quest Systems provides specialist property valuation software development services and is contracted exclusively to Quest End. Cywood is a management services company which provides development, management and director services to Quest Systems and through Quest Systems to Quest End.

## **TRANSACTION**

4. MDA UK proposes to acquire the whole of the issued share capital of Quest End, Quest Systems and Cywood. The parties made an informal submission to the OFT on 20 November 2006. The OFT's administrative deadline was 5 February 2007.

## **JURISDICTION**

5. The OFT is satisfied that two or more enterprises will cease to be distinct. Quest will cease to be distinct from MDA as a result of the proposed acquisition of the entire issued share capital of Quest End, Quest Systems and Cywood. The OFT believes that the parties' combined share of supply of property valuation network services in the UK exceeds 25 per cent and that therefore, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met.

## **FRAME OF REFERENCE**

### **Product market**

6. The parties submitted that both xit2 and Quest provide automated property valuation 'network services' that connect for example, mortgage lenders

with panel managers and valuers<sup>1</sup>. This provides the means by which property valuation instructions can be passed from the lender to a valuer through the panel manager and the completed valuations returned to the lender. The parties also submitted that both xit2 and Quest provide various software tools to network users that automate their processes for ordering, tracking and delivering property valuations over their networks. In this way, for example, cross keying information can be avoided and the whole process improved in terms of speed and accuracy of delivery. For the purposes of this transaction, the OFT refers to this software as 'workflow and administration software'.

7. In determining the product scope of the frame of reference for the assessment of this transaction, the OFT considered whether the supply of property valuation network services and workflow and administration software are part of the same composite product offering<sup>2</sup>. The parties submitted that the workflow and administration software they supply is ancillary to the provision of the network connectivity and is a composite product which meets the needs and demands of the specific lender, and panel manager within the valuation 'network'. The parties also submitted that there would be no or limited customer demand for the independent supply of the associated workflow and administration software separate from network connectivity (see note 1).
8. Third parties submitted that for large volume use it is essential that users within the network use compatible workflow and administration software and network connectivity. This in practice requires that users obtain the composite product from just one supplier due to problems with interfacing systems of different suppliers. Third parties also said that adopting the network services of one provider separately from the associated workflow and administration software does not offer the same level of functionality as adopting the complete 'end-to-end' solution (the composite product) from just one provider. The result is that the former becomes more costly, it takes longer to instruct and receive complete valuations and the need to cross-key property information increases the risk of errors. According to

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<sup>1</sup> Some third parties referred to the carrying out of the property valuation by a 'valuer' and others by a 'surveyor', for consistency within this decision the OFT uses the former term.

<sup>2</sup> The OFT has not been able to confirm the precise scope of the composite product. It appears that the process of instructing and receiving valuations becomes more efficient and is able to handle a larger volume of valuations the greater the integration of the user's workflow and administration software with that of the network supplier.

third parties, only for small volume use – where the economies of scale are not significant - is it viable for a lender or panel manager to adopt the workflow and administration systems of one supplier internally (or have an in-house system) and yet subscribe to the network services of another externally.

9. Moreover, third parties argued that while it can be straight forward to obtain network connectivity for small volume use (this might simply involve accessing a secure website) it can be very costly and take many months to switch to or adopt a more integrated system (the composite product) that includes workflow and administration functionalities and is able to handle a large volume of valuations.
10. The OFT therefore considers that the overlapping products for this transaction are the supply of property valuation network connectivity and workflow and administration software as a composite product.

#### Network Externalities

11. A lender may choose to use a particular full end-to-end system on the basis that many/most panel managers/ surveying firms (valuers) have already adopted and are fully integrated with that system and so, everything else being equal, this maximises the number of business partners they can deal with on the quickest and most cost-effective basis. Likewise, valuers will have a greater incentive to adopt the workflow and administration software of a particular composite product provider the larger the number of lenders that use that system (or the volume of valuations that are instructed through that system). In other words, the supply of network connectivity and workflow and administration software as a composite product is characterised by network externalities. Third parties also said that it is very costly to implement and maintain more than one full end-to-end system. On the basis of the evidence before the OFT most panel managers and some lenders have a full end-to-end system for most of their needs supplied by one provider (usually Quest) but also use a separate network provider (xit2) to obtain connectivity (albeit limited) with additional business partners<sup>3</sup> that do not use their main system provider.

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<sup>3</sup> By business partners the OFT means the lenders and panel managers/valuers.

12. The parties deny that network externalities are of any significant importance in this sector. However, third parties said they considered the existence of these to be a key characteristic of the composite product offered by the parties.
13. In seeking to define the product market in this case the OFT considered whether mortgage lenders would switch to alternative ways of obtaining connectivity with their business partners – other than the use of a third party supplier of network connectivity and workflow and administration software - given a small but significant and non-transitory increase in price (or reduction in quality) of such network services. In making their choice third party lenders claimed that they would consider the quality of the alternative systems, which includes factors such as scope of functionality, reliability, speed, etc; the overall price of using the alternative system; and the presence of switching costs, such as disruption to their business in switching software, training costs, and other costs.
14. The parties argued that lenders have three main options available to them for obtaining connectivity with valuers/panel managers other than outsourcing this to third party suppliers:
  - i. Self-supply
  - ii. Adopting an in-house, panel manager/ valuer system
  - iii. Using Automated Valuation Model (AVM) providers to obtain property valuations.

#### Self-supply

15. The parties argued that many lenders had, in the past, developed and applied their own internal systems to provide 'network' services direct with valuers which in total offered similar functionality to the Quest and xit2 networks. According to them these in-house 'network services' can be provided by (or a combination of): (i) telephone/fax; (ii) e-mail; (iii) direct internet connections (XML, VPNs or otherwise); (iv) other direct computer links; or (v) lenders' own secure website for connectivity.
16. With respect to the use of telephone, fax and e-mail, most third parties disagreed that these would be viable alternatives to automated property valuation network connectivity (including workflow and administration software). They said that these methods of obtaining connectivity between

lenders, panel managers and valuers had been more difficult to administer; much slower and would be impractical considering the large number of valuation requests that need to be handled centrally every day (even by a small lender) and that switching (back) to these methods would lead to higher costs to lenders - and so, ultimately, consumers/ property buyers - and be less cost and time effective.

17. Third parties claimed that automated property valuation network systems have been adopted by lenders and other business partners in the valuation chain to improve efficiency in the handling of valuations and thus have with time replaced the more traditional manual systems, suggesting that a return to these manual systems would be unlikely.
18. The parties argued however that customers/lenders can switch back to self-supply by developing their own in-house automated solution i.e. adopting or adapting their own workflow and administration software/systems and using their own secure websites to obtain connectivity with business partners. They provided some estimated costs of doing so which suggested that an entrant could break even at 90,000 transactions at £5 each. The OFT asked third parties (lenders) if they agreed with the estimated costs submitted by the parties of switching to this type of self-supply, and if they would consider switching. The responses received indicated that most lenders would neither be able to nor willing to switch to self-supply.
19. Some, though not all of the larger lenders broadly agreed with the parties' estimates of the costs of supplying a full scale automation solution (the composite product). However, a number commented that these costs did not appear to include the, potentially substantial, internal implementation cost of switching, the disruption to business while the new system is being integrated and the potential risk that panel managers and/or valuers would refuse to adopt such an alternative system. Most third parties - including those who agreed with the parties' estimates of development costs - said they would not consider developing an in-house system as they believed this would not be able to replicate a third party network widely adopted by panel managers and valuers. On the basis of the evidence before it, the OFT considers that an in-house system would not benefit from the same network externalities as an independent/third party system. Lenders also indicated they would be reluctant to switch to self-supply if this placed

them at a competitive disadvantage – i.e. if valuers took longer or charged more for dealing with their valuation instructions.

20. Moreover, the examples of lenders provided by the parties that continue to operate an in-house system were of lenders which also had their own in-house surveyors, i.e. who were not outsourcing the provision of valuation services. One of these lenders said they use a third party network provider (including the associated software) (in this case it was Quest) to outsource the valuations that cannot be carried out in-house or to allow their in-house surveyors to provide services to other third parties.
21. The parties did not agree that switching to self-supply would result in a less cost and time effective operation of the market, [ ]. However, the responses from both lenders and panel managers/valuers indicated that such a move would be less cost and time effective. Furthermore, lenders are not currently charged directly for the workflow and administration software and network services provided by the parties<sup>4</sup>. Therefore the OFT considers that they may have little incentive to react to changes in the price for network services (which might be absorbed by valuers anyway) and that any such increase would need to be substantial before it would lead to a lender switching to self supply.
22. Therefore while the ability of lenders to revert to an in-house system as an alternative to the parties' property valuation network services seems intuitively plausible, third party comments suggest that this would lead to higher prices and a reduction in service levels. Moreover, given the relatively small proportion of the total valuation fee accounted for by the parties' network services, such charges would need to rise substantially before switching to an in-house alternative would be considered. On the basis of the evidence before it therefore, the OFT does not consider that developing an in-house solution would be an effective substitute to a third party network supplier.

#### Adopting an in-house panel manager / valuer system

23. The parties submitted that panel managers and valuers could offer their own composite network product. In these cases, lenders could outsource

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<sup>4</sup> [ ]

some or all of their valuation work through connectivity with that panel manager/valuer 'in-house' system. They provided one example of this.

24. On the basis of the evidence before it the OFT considers that such a solution would not be as cost and time effective as using a composite product provided by a third party nor was there any evidence that such alternatives were (or were likely to be) widely available. Third parties submitted that such a system would require panel managers to cross-key instructions from the lender onto its 'network system' and lenders to manually 'map' completed valuations into their internal workflow/administration systems. To avoid this lenders could seek to adopt an internal system that would 'speak' to that of the panel manager/valuer. However on the basis of the evidence before it, the OFT considers the lenders would be reluctant to do this as it would restrict the number of business partners they can deal with on the quickest and most cost-effective basis.
25. Third party valuer firms and panel managers also did not consider that they would be able to develop a composite product in-house as this would be complex and time consuming. They also said that it would be extremely difficult to create interfaces with a large number of different lenders and that attempts to introduce such systems in the past have failed.

Using Automated Valuation Model (AVM) providers to obtain property valuations

26. AVMs, which are a relatively recent innovation in the UK property valuation market, use computer-based analytical methodologies and statistics, including prices of comparable houses in the neighbourhood, characteristics of the house itself, historical price appreciation, etc to value a property without requiring an onsite visit.
27. The parties submitted that AVMs, are a substitute product to the traditional property valuation survey and should be regarded as part of the same product market. The parties accepted that AVM take up, to some extent, depended on a lender's risk assessment policy. However, AVMs currently accounted for some 12 per cent of valuations by number in 2006 although the Council of Mortgage Lenders estimated that this was likely to increase to 40 per cent by 2010. However third parties, including mortgage lenders, claim that AVMs are not a substitute to all types of valuations. The general view was that AVMs are only adequate substitutes at low loan-to-value

levels, where the property type is relatively homogenous and a reasonable amount of appropriate sales data is available. In those cases an AVM could produce a valuation that was sufficiently accurate so as to satisfy a lender's 'risk' level such that a 'full' valuation was not required. However, if the AVM produced a figure that was above the lender's risk level then a full valuation would still be required. Third parties also pointed out that an AVM was substantially cheaper than a full valuation - £10-25 compared to [ ].

28. The parties also submitted that an AVM provider could easily enter the supply of property valuation network connectivity since it already had a business relationship with the lender concerned. However, a third party AVM provider argued that an AVM link with a lender was fundamentally different to the link that lenders and panel managers would have with composite product providers. Moreover, while the OFT received comments from a number of lenders, all of which had links, one way or another, with AVM providers, none of those lenders suggested that those links could be expanded to compete with the parties' network services.
29. In conclusion, the OFT therefore considers that the relevant product scope of the frame of reference for assessing this merger is the supply of property valuation network connectivity and workflow and administration software as a composite product. However, on the basis of the evidence before it, the OFT believes that the competitive constraint on the parties, if any, provided by self supply, the panel manager network and AVMs is at best weak.

### **Geographic market**

30. Most of the mortgage lenders who use property valuation network services have a national presence and so need to have access to valuation services on a national basis. Smaller lenders may have a more regional bias and so only require valuation services on a local or regional basis. However, the nature of the 'service' provided by the parties does not differ whether it is required to cover a local, regional or national geographic area. Therefore, the OFT considers that the appropriate geographic scope of the frame of reference for the assessment of this transaction is the UK.

## HORIZONTAL ISSUES

31. As noted above, the parties believed that the market for the supply of property valuation network services should include in-house (self) supply, panel manager networks and AVMs as well as third party network providers such as the parties. On this basis, the parties estimated their combined share of supply, by number of valuations in 2006, to be some 50 per cent (increment 10 per cent) – with self supply at about 20 per cent, panel managers 11 per cent and AVMs at 12 per cent.
32. Most third parties submitted that in their view Quest and xit2 were the only third party network suppliers in the UK. A number of third parties estimated that the parties' respective shares of supply were in the region of 85 per cent for Quest and 15 per cent for xit2 and that xit2 was rapidly gaining share from Quest. [ ]. The parties provided the OFT with the details of two direct if smaller third party property valuation network providers. One of these told the OFT that it no longer marketed or provided valuation network services. The OFT was unable to make contact with the other although few of the other third parties consulted had heard of it.
33. Discussions with third parties indicate that many lenders, panel managers and valuers now have Quest's software installed for their workflow and administration needs. To this extent, Quest has benefited from first-mover advantage in being able to persuade lenders to switch from self supply to a more efficient and comprehensive third party 'network'. The extent of any such advantage may be substantial since third parties, as mentioned above, considered the cost of switching workflow and administration software to be high.
34. A number of users of Quest's workflow and administration software told the OFT that they are still able to use an alternative *network* (xit2's VEx) but because they need to manually cross-key information between their workflow and administration systems and the alternative network, which is resource intensive and carries the risk of errors being made, they use the alternative network only partially and not for the bulk of their business.

35. In order for such customers to use xit2's VEx for a larger volume of transactions they told the OFT they would need to integrate more fully with xit2 – i.e. adopt xit2's associated workflow and administration software. However, as the technology is not off-the-shelf and would need to be custom built for every user, which is costly and can take many months or years, these customers said they would only make such an investment if more (than at present) of their business partners also switched to VEx and xit2's associated software.
36. It appears to the OFT that xit2's business strategy has been to seek to switch lenders to xit2 (its workflow and administration software as well as using its network) who were still self-supplying. However, the OFT has found evidence of panel managers/valuers having now integrated more fully with the xit2 system in order to be able to handle a larger volume of valuations using this system; and of a large mortgage lender switching to the xit2 system from Quest. Some third parties told the OFT that they believe xit2's take up within the industry has been low as a proportion of the size of the market; but that, nevertheless, its entry has created an impetus for Quest to review their own offering, resulting in improved levels of service and system functionality. Others believe that xit2 would have overtaken Quest as the leading valuations network absent the merger.
37. With respect to the effect that entry by xit2 has had on Quest, the OFT considered the impact on Quest (in terms of price, quality and research and development expenditure) of xit2's entry. Quest submitted that it does not track research and development expenditure in its accounts so instead provided estimated figures. The figures submitted do not indicate large expenditure in this area. However, the OFT noted that Quest hired 2 extra developers (one in 2002 and one in 2003) immediately after xit2 entered the market although Quest submitted that there were other reasons for this which were unconnected with xit2 entry (including that the number of customers was increasing and that the business and technical environment was becoming more complex).
38. In terms of prices, Quest submitted that 'Quest's SPN prices have remained unchanged since the SPN was launched in 1998<sup>5</sup>, with a total average cost of [ ] per case'. Quest submitted that its annual support prices are linked to RPI and that development work for bespoke workflow

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<sup>5</sup> Third parties have told OFT that Quest has provided a valuations network for over 20 years.

and administration software is charged at [ ] per day. The OFT was unable to confirm whether this was the case. With respect to impact on quality and service offering, the parties did not provide any evidence to show that Quest's offering had not been affected by xit2's entry. However, several third parties mentioned that the Quest's system was outdated when compared to xit2's and some said that they believed Quest had improved its system as a result of xit2's entry.

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

39. The parties estimated that the cost of developing a competing system similar to xit2's supplying 90,000 transactions a year would be approximately £1m and that the time required to develop the software would be around 6 to 12 months (see note 2). As mentioned above, some but not all third parties agreed with this. Where the parties' submission and third parties' views differ significantly, however, is with respect to the ease with which customers may be acquired.
40. The parties argue that users face minimal switching costs – that all that is required to start using an alternative network is to have access to broadband and to become familiar with a new web site. However, on the basis of the evidence before it, the OFT considers that this is only the case for small volume use. For larger volume use, customers need to also adopt the associated workflow and administration software of the new network provider<sup>6</sup>. Third party customers who have switched to/adopted xit2's full composite product of network connectivity and workflow and administration software said the internal costs involved in switching the composite product are significant and that it can take many months or years to complete.
41. Third parties have also told the OFT that mortgage lenders are not very price sensitive in the context of property valuation network services. Internal documents provided by the parties also mention that 'customers

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<sup>6</sup> The OFT considers on the basis of the evidence before it, that the introduction of the internet may have reduced barriers to entry in this sector somewhat by allowing 'small scale' entry. That is, it may be enough for a new entrant to switch one or a few lenders only to its workflow and administration software and valuers can communicate with these lenders via the new entrant's web site. However, the internet does not remove the need for a new entrant to have to switch lenders' internal workflow and administration software and in order to obtain the network externalities panel managers/valuers would eventually need to adopt the corresponding workflow and administration software.

are sticky due to custom interfaces'. The OFT also found evidence of failed entry in this sector due to difficulty in switching users' workflow and administration systems or of interfacing with these systems.

42. As mentioned above, the OFT also believes that xit2's strategy for entering the market was to switch large mortgage lenders that had not yet adopted the Quest system. On the basis of the evidence before it, the OFT believes that most of the top mortgage lenders in the UK have now adopted either the Quest system or the xit2 system, and that therefore a new entrant would face higher barriers to entry than xit2 faced when it first entered the market<sup>7</sup>.
43. Third parties responses also indicated that a new entrant would need to 'switch' more than one main lender in order to replace the competitive constraint that would be lost through the merger. On the basis of the evidence before it, the OFT considers that xit2 was not as strong a competitive constraint on Quest when it was first introduced as it is now as it had not yet developed a network.
44. Therefore, on the basis of the evidence before it, the OFT considers that due to the presence of network externalities, a new entrant would be less attractive to a lender or valuer contemplating switching (whether from Quest or self-supply) than would xit2, which already has a developed network to a significant extent.
45. Given the switching costs faced by users and the time taken to switch users' workflow and administration software, the OFT does not consider on the basis of the evidence before it that a new entrant would be able to (a) develop a new system and (b) build a network of a sufficient size within two years to replace the competitive constraint that will be removed with the merger. The majority of third parties who responded were also of the view that new entry in this sector would be difficult and unlikely. Therefore, on the basis of the evidence before it, the OFT does not consider that entry would be sufficient in time; scope or likelihood in order to constrain the parties post-merger.

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<sup>7</sup> Moreover, on the basis of the evidence before it, the OFT believes that xit2 took advantage of a leap in technology, which was the widespread use of internet broadband, in entering this market by providing a more advanced system to Quest's.

### **Countervailing buyer power**

46. The parties argue that buyers (in particular lenders) have significant power over suppliers of valuations networks and associated software.
47. On the basis of the evidence received from third parties the OFT does not consider that a buyer (lender or valuer) would have enough buyer power on its own to break away from a network in order to self-supply the composite product to enable it to communicate with its business partners. Any buyer doing this would not benefit from network externalities and may be placed at a competitive disadvantage when compared to its competitors. Moreover, the majority of third parties/ users of the existing networks who responded to us said they would not be able to self-supply and/or do not consider this option to be a viable alternative to the use of a composite product.
48. The majority of third parties did not consider they would have enough buyer power on their own to prevent a price increase/reduction in service quality by the merged entity. However, two users considered that they might be able to sponsor entry 'in conjunction with other potential end users'. It is not clear to the OFT how network users would coordinate to jointly sponsor entry, however, nor if this would be likely to occur within two years.

### **VERTICAL ISSUES**

49. The OFT does not believe that this transaction raises any vertical issues.

### **THIRD PARTY VIEWS**

50. Third party views have been discussed above. Most of the third party mortgage lenders and panel manager/ surveyor firms who commented were concerned about the merger. Some third parties thought that this merger may give rise to efficiency gains by creating incentives to make the parties' systems interoperable. However the OFT has not been able to clarify or quantify these.

## ASSESSMENT

51. The OFT considers that the appropriate frame of reference for the assessment of this transaction is the supply of property valuation network connectivity and workflow and administration software as a composite product. However the OFT believes that the competitive constraint, if any, on the parties provided by self-supply by lenders, panel manager networks and AVMs is at best weak.
52. The evidence the OFT has found shows that network externalities are important in this sector; that the parties are the only two suppliers in the market recognised by third parties and that they are regarded as each others' closest competitors. Furthermore the OFT considers that barriers to entry are high and most third parties did not consider they would have enough buyer power on their own to prevent a price increase/reduction in service quality by the merged entity. Although two users considered that they might be able to sponsor entry 'in conjunction with other potential end users' it is not clear to the OFT how this would work or whether it would be sufficiently timely to constrain the merged entity.
53. As mentioned above, the business strategy of both parties has been based upon the ability to encourage lenders to switch from self supply to an external property valuation network. They have only been able to do so to the extent that such an external network can be seen to provide efficiencies in terms of costs, quality and speed of delivery. Therefore on the basis of the evidence before it, the OFT considers that for lenders switching away from self-supply, the parties are closest competitors. Moreover, on the basis of the evidence, the OFT believes that going forward xit2 would only have been able to continue to expand by persuading lenders to transfer in whole or in part their property valuation business from Quest to xit2. Such competition or rivalry would be lost as a result of the merger.
54. 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

55. 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.
56. 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 *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).
57. The parties offered the following undertakings in lieu of reference to the Competition Commission in order to address potential concerns regarding barriers to entry and the potential for increased prices:
  - i. [ ]
  - ii. [ ]
  - iii. [ ]
  - iv. [ ]
58. Although (i) above may deliver some efficiency benefits, the OFT does not consider that it resolves the competition concerns raised by this transaction and may actually raise barriers to entry. We understand from the parties that [ ]. On that basis, the OFT does not believe that (ii) above offers anything additional. (iii) above seeks to limit prices to increases in RPI, however, it may be the case that prices would fall absent the merger, particularly if the parties faced more head-to-head competition. This does not, either, resolve the service or quality concerns. Nor does the OFT

consider that (iv) above would be capable of replicating the network externalities which third parties value.

59. The OFT therefore does not consider that the parties have offered undertakings that would resolve the competition concerns raised by this merger. Accordingly, the OFT has decided not to exercise its discretion under section 73(2) of the Act to consider whether to accept undertakings in lieu of a reference.

## **DECISION**

60. This merger will therefore **be referred** to the Competition Commission under section 33(1) of the Act.

## **NOTES**

1. The parties asserted that there would be no or limited customer demand for the separate independent supply of network connectivity and the associated functionality contained in workflow and administration software specifically dedicated to supporting the network.

2. The parties asserted that a competing system could be developed for £1million which could break even at 90,000 transactions although would be capable of processing a larger number.