
Completed acquisition by Stagecoach Group plc of Preston Bus Limited

ME/4032/09

The OFT's decision on reference under section 22(1) given on 28 May 2009. Full text of decision published 11 June 2009

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. **Stagecoach Group PLC (Stagecoach)** is a wholly-owned subsidiary of the Stagecoach Group, an international public transportation group, with operations in the UK, USA and Canada. Stagecoach Northwest – the division responsible for the current transaction – employs around 1,400 staff and operates around 530 buses in Lancashire and Cumbria.¹ Pre-merger Stagecoach operated intra-urban, inter-urban, commercial and tendered bus services in the Preston area.
2. **Preston Bus Limited (PBL)** provided tendered and commercial bus services in the Preston area. For the year ending 30 March 2008, PBL's turnover was £11.2 million. PBL was an employee-owned company.

TRANSACTION

3. On 23 January 2009, Stagecoach, through Stagecoach Bus Holdings Limited, acquired PBL for a consideration of £[] million. As a result of the transaction, Stagecoach purchased 127 buses and a depot

¹ Excluding the buses formerly operated by Preston Bus.

with capacity for 130 buses, as well as taking on 299 employees. It also agreed to take on the liability of PBL's pension fund, which was in debt at the time of the merger.

4. PBL's pension fund is managed by West Midlands Passenger Transport (WMPT) and guaranteed by Preston City Council. At the time of the transaction, the fund was between £[] million and £[] million in deficit (the variance reflecting various different estimates). Under the terms of the fund, should PBL no longer be responsible for making payments into the fund (including if it goes out of business), Preston City Council is liable to cover any shortfall (that is, between £3 million and £7 million at the time of the acquisition). Preston City Council's position as guarantor and WMPT's position as fund manager were not affected by the merger.

JURISDICTION

5. On 23 January 2009, Stagecoach acquired PBL and the OFT therefore believes that, as a result of the transaction, PBL has ceased to be distinct from Stagecoach for the purposes of the Enterprise Act 2002 (the Act).
6. The merger was investigated by the OFT of its own volition. The OFT's administrative deadline was 18 May 2009, and the statutory deadline, as extended, is 18 June 2009.
7. The parties overlapped in the provision of commercially operated intra-urban bus services in Preston.
8. Stagecoach has questioned whether Preston should be treated as constituting a 'substantial part of the UK' for the purposes of the share of supply test under section 23(4) of the Act. It contends that both the population of Preston (approximately 131,000) and its geographic area (approximately 144 square kilometers), are sufficiently small such that it is not a substantial part of the UK.
9. While there is no statutory definition of what constitutes a 'substantial part of the UK', the House of Lords in *Regina v Monopolies and Mergers Commission and another; ex parte South*

Yorkshire Transport Limited ('ex parte South Yorkshire')², involving the merger of two local bus companies in South Yorkshire, considered that this definition required that an area or areas must be considered of such size, character and importance as to make it worth consideration for the purposes of merger control. In that case, Lord Mustill stated that:

'...where the task is to interpret an enabling provision, designed to confer on the commission the power to investigate mergers believed to be against the public interest the court should lean against an interpretation which would give the commission jurisdiction over references of the present kind in only a small minority of cases. This is the more so in the particular context of local bus services, since the provision of adequate services is a matter of importance to the public, as witness the need felt by Parliament to make special provision for them in the Transport Act 1985.'

10. The OFT has taken proper account of this comment in determining its approach to the application of the 'substantiality' criterion under section 23(4) of the Act. In addition, the OFT notes that Preston's population is larger than that of Slough (approximately 120,000), which the CC found to constitute a substantial part of the UK in its report on Tesco/Co-Op store acquisition in Slough.³
11. In light of the above factors, in particular Lord Mustill's comments in *ex parte South Yorkshire*, and taking account of the fact that the OFT is required to decide on the existence of a relevant merger situation on an 'is or may be the case' standard, the OFT considers it reasonable to view Preston as a substantial part of the UK for the purposes of UK merger control.
12. The parties have a combined share of supply of over 80 per cent, by mileage, of commercially operated intra-urban bus services in the city of Preston, and the 'share of supply' test under 23(2) of the Act is therefore met.

² [1993] 1 ALL ER 289

³ 28 November 2007.

MARKET DEFINITION

Intra-urban services

13. Stagecoach and PBL overlapped in the supply of local bus services in Preston. Until 2007, Stagecoach's network covered an area predominantly in the south of the city and PBL's covered an area in the north. Since 2007, the two networks have overlapped significantly, particularly in the north of the city, as a result of Stagecoach expanding its operations.
14. Pre-merger, Stagecoach operated 20 commercial services in Preston⁴ and PBL operated 18.⁵
15. In previous merger investigations involving passenger transport, the OFT and the CC have tended to focus on the competitive effects of the merger rather than specifically defining the appropriate relevant market. In practice this has meant considering the competitive constraints on different transport modes on a flow-by-flow basis (and where relevant, an analysis of network effects, if any) in order to determine whether the merger may provide an incentive to increase fares or reduce service levels. In order to focus attention on those flows most likely to raise concerns, the CC has developed a number of 'filters' to identify flows on which the merged entity is unlikely to have either the incentive or ability to exercise market power post-merger.⁶ These filters are not safe harbours, however, and the OFT is not bound to apply them in every case. Especially on flows where a transaction results in only one operator on a given flow, further analysis may be required.
16. Applying the CC filters to the present case, Stagecoach submits that only eight flows would remain for consideration.⁷ Stagecoach argues that the OFT's competitive assessment should therefore be confined to these eight flows.

⁴ Eight of these services were part-tendered.

⁵ Two of these services were part-tendered.

⁶ Competition Commission *Review of Methodologies in Transport Inquiries* (2006). In practice, flows are excluded where a flow comprises less than ten per cent of the total revenue of a route and where the frequency of overlapping services is less than half as frequent as the main service (e.g. one is every 15 minutes and one is hourly).

⁷ The services affected on these flows were: Stagecoach service numbers 1, 3, 9, 11, 19, 33; and PBL service numbers 3, 8, 11, 16, 19, 31, 35, 44.

17. In this case, the OFT considered two different analytical approaches to assessing the effect of the merger on competition. However, it did not need to conclude on which was the most appropriate as it considered that the outcome of its competition assessment would be the same under both approaches.
18. The first approach followed that used by the OFT and CC in most previous cases. This eschewed (or downplayed) market definition and instead focussed directly on the competitive constraints removed by the merger. As well as assessing those areas of actual overlap, this involved an assessment of potential competition or supply-side reactions between the parties on those flows where only one party was present but the other operated close by.
19. The second approach involved the OFT defining numerous flow-specific markets but aggregating them for the purposes of its competitive assessment under the rubric of 'intra-urban commercial bus services in north Preston' (and perhaps even Preston itself) to encompass both overlapping and non-overlapping flows between the parties.
20. The reason for aggregating individual flow-specific markets in this way in this case is because the parties' networks overlapped extensively, particularly in the north of Preston and in a small area in the south west.⁸ Many routes of one party ran on, or close to, those of the other. Even on flows where the parties did not therefore directly overlap, in many instances it appears that it would have been relatively easy for the parties to alter or add to existing services to compete head-to-head with each other (for example, by extending or altering an existing route's path), thereby imposing an effective constraint on each other's behaviour (see the 'Potential Competition' section below). In the OFT's view, this ease of supply-side reaction would therefore imply a series of separate flow 'markets' in which both parties are considered to be participants (even though only one is currently active in them).
21. For convenience, and given that competitive conditions are the same or similar across most of the parties' pre-merger routes in north

⁸ Stagecoach and PBL both operated the number 3 route in south west Preston. For ease of reference, the overlapping area of the two parties' networks will hereafter be referred to as 'north Preston'.

Preston, the OFT considered it would be appropriate to aggregate all (overlapping and non-overlapping) flow markets and assessed the merger on the basis of an overall market for north Preston.

Tendered services

22. Tendered services tend to be for a fixed duration and contain set parameters such as price and quality levels. Operators compete with each other to provide these services under contract from councils, with the lowest bid usually winning the tender. Tendering usually occurs for routes that would be loss-making for a commercial operator, so the overlap between them and commercial routes is often minimal. Many of the companies competing for tendered services in Preston do not operate commercial services.
23. Unlike the situation for commercial services, the OFT identified a large number of other operators of tendered services in Preston besides the parties, some of which had a record of winning tenders from Stagecoach. Most of these firms operated tendered services only. Further, Lancashire County Council, which awards tendered services to bus operators, was of the view that there would be no reduction in competition for tendered services in Preston as a result of the merger.
24. In light of the above, and given the fact that no concerns were raised in relation to tendered services in Preston, the OFT considers competition concerns are unlikely to arise with respect to tendered services and these are not discussed further.

Inter-urban services

25. Stagecoach provided, and still provides, inter-urban services between Preston and surrounding locations. PBL did not provide any inter-urban services.
26. Market enquiries indicated that inter-urban services are unlikely to be a constraint on intra-urban commercial services in Preston, given they tend to operate, and stop, less frequently than intra-urban services. Moreover, the overlap flow for inter-urban services often accounts for less than 10 per cent of route revenue, and would therefore be excluded using the CC's filter methodology. One inter-

urban operator advised that it was unaware of Stagecoach's pricing structure and did not set its prices with intra-urban operators in mind.

27. In light of the above, and given no competition concerns were raised in relation to these services, the OFT considers competition concerns are unlikely to arise and inter-urban services are therefore not discussed further.

Other forms of transport

28. Stagecoach submitted that the merged firm is likely to face competition on all routes and flows from cycling, walking, taxis and private cars. With respect to private cars and taxis, Stagecoach has submitted that taxi fares for certain journeys in Preston are comparable to bus fares if the taxi is shared between three people. Further, Stagecoach advised that the Preston City Council has been negotiating with private hire taxi firms about the possibility of private hire firms providing local bus services in Preston.
29. In past merger enquiries, the OFT and CC concluded that there was limited substitution between public and private transport in response to changes in relative prices. Similarly, in this case, the OFT did not receive any substantiated evidence that taxis, private cars, walking or cycling would be likely to provide a constraint on bus pricing in Preston. The OFT was also not satisfied that private hire taxi companies would provide a viable alternative for most bus users, even if they do begin operating local bus services in Preston.
30. In this case, the OFT does not consider that other forms of transport, including other types of bus and coach services, would be likely to constrain the merged entity's commercial local bus operations in Preston.

COMPETITIVE ASSESSMENT

Counterfactual

31. Paragraph 3.24 of the OFT's Substantive Assessment Guidance⁹ states:

'In most cases, the best guide to the appropriate counterfactual will be prevailing conditions of competition. However, the OFT may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger.'

32. An example of the likely and imminent changes that the OFT may need to have regard to is whether the target company is a 'failing firm'. Stagecoach submits that PBL was failing and that this should be taken into account for the purposes of the counterfactual.
33. The OFT's position on how it will assess an exiting (including failing) firm defence was recently articulated in the 'Restatement of OFT's position regarding acquisitions of 'failing firms''.¹⁰ The OFT confirmed in that restatement that it will only clear a transaction based on 'failing firm' claims where it has sufficient compelling evidence that the following conditions are met:
- a. absent the merger, the target business would have inevitably exited with no serious prospect of re-organization, and
 - b. there was no realistic and substantially less anti-competitive alternative to the merger.

Likelihood of PBL's exit from the market

34. In the present case, the prevailing conditions of competition were that Stagecoach and PBL were competitors in the local commercial bus market in Preston. However, Stagecoach contends that, at the time of the acquisition, PBL was in severe financial difficulties and its exit from the market was imminent and inevitable. Stagecoach submits that there was no serious prospect of re-organising PBL to

⁹ Mergers Substantive Assessment Guidance (OFT 506).

¹⁰ Published on 18 December 2008. See the OFT's assessment of HMV's anticipated acquisition of 15 Zavvi stores, 28 April 2009, for a recent application of this approach.

make it profitable going forward, citing a report from PBL's financial advisors that supported this proposition.

35. A substantial amount of evidence was put to the OFT supporting the proposition that PBL was in serious financial trouble at the time of the sale, and that the business was 'not viable in its current form'. PBL's accountant was of the view that PBL would be in negative balance sheet equity in around six months. The OFT's own evaluation of PBL's accounts is consistent with this view. In addition to the auditor's report provided by Stagecoach, PBL's management accounts indicate that PBL was losing between £[.] and £[.] per month just prior to the merger. Further, Preston City Council commissioned its own evaluation of PBL which confirmed that PBL was in severe financial difficulties.
36. In terms of re-structuring the business, the evidence before the OFT suggests that any successful re-organisation of the business (to the extent that this was possible) would most likely have involved down-sizing the scale of PBL's operations and would probably have led to job losses or potentially salary reductions. Such a strategy may have been complicated by the fact that PBL was employee-owned. Indeed, the OFT understands that PBL employees had previously reacted negatively to cutback proposals.
37. However, while the OFT accepts that such a strategy may have been difficult to implement given the ownership structure of the company, the prospect of reorganising through cutting staff and services was never considered in any detail; namely because PBL had decided to pursue a sale instead. However, had negotiations with Stagecoach fallen through, PBL would presumably have had to consider this option in more detail. The OFT considers it plausible that, when faced with the prospect of going out of business, PBL may have been willing and able to reorganise its operations by, for example, cutting back services and shifts. While this measure would not have been popular with all staff, it may well have been judged preferable to all employees losing their jobs.
38. Therefore, whilst the OFT believes that it is plausible that the first limb of the failing firm criteria (inevitable exit with no prospect of re-organisation) may be met, it considers it a realistic possibility that PBL could have continued, albeit with reduced services, had sales

talks with Stagecoach broken down. However, the OFT did not need to conclude on this point given that it found there was a realistic and substantially less anti-competitive alternative to Stagecoach acquiring PBL (see below).

Prospect of a less anti-competitive acquisition of PBL

39. Stagecoach contends that there was no other realistic bidder for PBL and that, absent Stagecoach acquiring it, it would have gone into administration and possibly liquidation. In the event of PBL being liquidated, it submits there was no guarantee that any of the assets would have been used to compete against Stagecoach in Preston.
40. Once the decision was taken to sell the business, PBL contacted a number of transport companies, all of which had sizeable bus operations in the UK. It did not, however, contact Stagecoach at first instance. Of the companies contacted, only two indicated any interest: Arriva and Go Ahead.
41. Arriva advised the OFT that it was only interested in acquiring PBL if it was also able to acquire Stagecoach's Preston operations. Although it put in an initial bid for PBL, once it became clear that (a) it would not be able to also secure Stagecoach's Preston operations; and (b) PBL's financial position was deteriorating rapidly, Arriva withdrew from the process. In any event, Arriva's initial bid for Preston excluded it taking on any liability under the pension fund and was less than the amount that PBL's owners (its employees) would be liable to pay to WMPT to make up the deficit in the fund.¹¹
42. The second interested party, Go Ahead, submitted a bid for PBL that also excluded the pension liability and was substantially less than the amount required to get the pension fund out of deficit. Like Arriva's offer, this would also have left PBL's owners liable to make up the deficit in the pension fund to WMPT.
43. In light of the above, Stagecoach submits that PBL would have gone into administration had Stagecoach not acquired it. It further submits that it is unlikely that PBL would have continued trading under administration due to the significant losses it was incurring. In addition, any business sale would still include the pension liability

¹¹ See End note I

which no company other than Stagecoach was prepared to take on. Under these circumstances, Stagecoach argues that PBL would most likely have been liquidated, with no guarantee its assets would have remained in the market.

44. On the evidence before it, the OFT considers there would have been no other realistic purchaser of PBL in the event that Stagecoach had not acquired it. No company expressed an interest in taking on the pension liability and the OFT is satisfied that no other purchaser would have been prepared to acquire it with this liability still attached. The OFT therefore believes that there was no other realistic purchaser willing to pay above liquidation value¹² to acquire the business as a going concern.
45. However, the OFT is also required to consider in this context realistic counterfactuals to the merger in the event that PBL could not be sold as a going concern and was instead liquidated. This scenario is of particular relevance in this context because, had PBL been liquidated, any purchaser(s) of PBL's assets would have done so without the pension liability (which would instead transfer to the Preston City Council).
46. The OFT therefore considered whether – in the absence of the acquisition of PBL by Stagecoach – the assets of PBL would inevitably have exited the market or whether they might realistically have been acquired by a third party with a substantially more competitive outcome than the merger.
47. While the OFT recognizes that PBL's assets, and particularly its depot, may have been of most commercial value to Stagecoach given its existing position in the Preston market,¹³ it cannot rule out the possibility that another bidder would have been successful in acquiring at least some of PBL's assets in these circumstances.¹⁴ As discussed above, Go Ahead expressed an interest in acquiring PBL

¹² This is the standard applied by the OFT, as stated in the *Restatement of OFT's position regarding acquisitions of 'failing firms'* (see footnote 11, above). In this context, the OFT considers it reasonable to treat offers which would have left PBL's owners with an actual loss after their liability to make up the deficit in the pension fund to WMPT as being below liquidation value.

¹³ [.]

¹⁴ Approximately one quarter of PBL's buses were leased by PBL on a hire-purchase agreement and these may have reverted back to their owners had PBL gone into administration.

(and therefore commencing local bus services in Preston) notwithstanding this would have put it in competition with Stagecoach. Moreover, Go Ahead advised the OFT that it would have looked at acquiring PBL's assets in the event PBL was liquidated.¹⁵ Further, other bus companies in the area may have seen such a sale as an opportunity to expand their operations to areas previously serviced by PBL.

48. Therefore, while the OFT accepts that one possible result of PBL being liquidated is that Stagecoach would ultimately have acquired most or all of PBL's assets, given the likely interest from at least Go Ahead, it considered there is a realistic prospect that another company (or companies) could have acquired PBL's assets and used them to operate commercial local bus services in Preston in competition with Stagecoach.¹⁶
49. In light of Stagecoach's relatively large pre-merger market share in Preston, the OFT considers that, in the event PBL was liquidated, almost any other company would have been a substantially less anti-competitive alternative to Stagecoach acquiring PBL. Although the OFT accepts there is a possibility of some very short-term consumer detriment arising in the time between PBL's liquidation and a purchaser acquiring its assets,¹⁷ the OFT considers that the medium and long term structure of the market would be substantially more competitive in such a scenario.
50. As a result the OFT does not believe that the available evidence is sufficient to accept the failing firm criteria at phase I in the present case.

¹⁵ Although Go Ahead advised that it thought these assets may have been valued higher by companies already in the area.

¹⁶ Contrast the OFT's decision in *Anticipated acquisition by First West Yorkshire Limited of Black Prince Buses Limited*, 27 May 2005, where the OFT found that letting the target company fail would not have been a substantially less anti-competitive than the acquisition because it was unlikely that anyone would acquire the assets and use them to replace the competitive constraint lost by the merger. In that case, also involving local buses, the target's assets did not include a depot in circumstances where the OFT found access to depot space a significant barrier to entry. Anyone acquiring the assets would therefore also have needed to invest a substantial amount of money in a new depot. In that particular case, the OFT found that it was unlikely that anyone would do this.

¹⁷ For example, due to customer confusion surrounding timetabling and ticketing.

Conclusion on counterfactual

51. The OFT considered it possible that PBL would have failed absent the merger, but did not need to conclude given that in this case it makes no material difference to the substantive analysis of the merger. Whether PBL continued on in a reduced form, or whether its assets were acquired by another company, the OFT considers it plausible that Stagecoach would have continued to face competition from an independent operator of commercial bus services in Preston.
52. Were the merger to be assessed by reference to a counterfactual where PBL's assets were acquired by another purchaser, the OFT considers that, due to the uncertainty surrounding how PBL's assets would be used to compete in the market, and in the context of a first phase investigation, it is appropriate to use PBL as a proxy for the purchaser of the assets,¹⁸ whilst accepting the possibility that the purchaser could have decreased (or indeed increased) the frequency and coverage of services compared to that provided by PBL pre-merger.
53. The acquisition has therefore been assessed against the prevailing conditions of competition at the time of the merger (that is, PBL's continued operations), taking into account, where relevant, the possibility that a new operator may have acquired PBL's assets and used them to compete in Preston.

Horizontal Issues

'Flow by flow' competition analysis and assessment of potential competition issues

Actual competition

54. Pre-merger, the parties operated commercial local bus services in Preston, with approximately [above 75] per cent market share by mileage. Their networks overlapped extensively and on approximately 120 flows on which they overlapped they were the only two operators. In particular, in the absence of competition from other sources or the threat of new entry or expansion, an application

¹⁸ See, by analogy, the OFT's decision in *Anticipated acquisition by Tesco Stores Limited of two former Kwik Save stores*, 7 November 2007 at 13.

of the CC filtering methodology indicates that the merger may have given Stagecoach the incentive to increase fares and/or decrease service frequencies on eight flows, potentially affecting 14 different routes.

55. Nevertheless, Stagecoach submitted evidence arguing that the competitive constraint that each party had on the other was limited. For example, Stagecoach contends that PBL's prices were higher than Stagecoach's and it did not lower them in response to entry from PBL. Further, when PBL began operating one route in direct competition with Stagecoach, Stagecoach did not respond at all.
56. Although there may be instances where direct competition did not elicit a response, the evidence before the OFT is insufficient for it to conclude that the competition between Stagecoach and Preston prior to the merger was ineffective.
57. The fact that an action does not provoke an obvious competitive response does not necessarily mean it is not having an effect. For example, Stagecoach concedes that its revenues decreased by [15-35] per cent upon PBL commencing head-to-head competition on one of Stagecoach's routes. The OFT further notes also that, following allegations made by both parties, Stagecoach and PBL were summoned to a hearing by the North West Traffic Commissioner in 2007 regarding the way in which they were competing for passengers. This resulted in Stagecoach and PBL signing a memorandum of understanding concerning their competitive conduct going forward.
58. In any event, as noted, a realistic counterfactual to the merger is PBL operating a reduced number of services, or a third party operator purchasing and using PBL's assets. While the OFT recognises that competition between the parties under either of these alternative counterfactuals may not be as intense as it was pre-merger (particularly with respect to a different operator using PBL's assets), the OFT considers that the evidence of past competition nevertheless carries some probative weight regarding the degree of competition lost as a result of the merger. Indeed, Go Ahead advised the OFT that it considered PBL's operations could be reconfigured in such a manner as to make it profitable, notwithstanding competition from Stagecoach.

59. The OFT therefore considered that Stagecoach would have been constrained by PBL, or a purchaser of PBL's assets, going forward (and vice versa). This competition has been lost as a result of the merger.

Competition from other competitors

60. Two other companies, John Fishwick and Sons (Fishwicks) and Rojay Services Limited (trading as 'Blue Bus') (Blue Bus) operates local commercial services in south Preston. However, the OFT considers it unlikely that these companies provided an effective competitive constraint on the parties pre-merger, and would be unlikely to constrain Stagecoach going forward.
61. Fishwicks operates six services in the south of Preston, two of which, pre-merger, - the 111 and 115 - overlapped with the parties' number 3 service. The 115, in particular, overlapped substantially with the number 3 service. Nevertheless, Fishwicks' 115 service operates on an hourly basis only, and is therefore unlikely to have been a competitive constraint on the parties.
62. Blue Bus operates two services in the south of Preston: the number 5 and the number 26. At the time of the OFT's decision, however, the OFT understands that the number 26 is to be withdrawn from service, with the buses to be used on a new, shortened route 5 (which will become known as route 110). Pre-merger none of these services overlapped with the parties' commercial intra-urban services,¹⁹ and it therefore did not provide actual competition to the merger parties.

Conclusion on actual competition

63. It is therefore reasonable to consider that, pre-merger, both parties acted as a competitive constraint on each other and Stagecoach would have continued to face competition going forward. In the absence of effective competition from other sources and any countervailing factors, there is therefore a realistic prospect of a substantial lessening of actual competition in relation to the eight overlapping flows remaining after application of the CC filter.

¹⁹ Blue Bus' number 26 service did, however, overlap with Stagecoach's 125/126 Preston-Bolton inter-city service.

Potential competition

64. Pre-merger, the parties operated networks that overlapped substantially, particularly in the north of Preston. The OFT therefore considered whether the merger has removed a competitive constraint by virtue of removing the most likely potential competitor on flows where the parties did not overlap.
65. Stagecoach expanded extensively onto PBL's routes from the time it began intra-urban operations in north Preston in 2007. The OFT therefore considers it very likely that Stagecoach was PBL's most likely potential competitor. The OFT notes, in addition, that PBL also made adjustments to its routes and frequencies during 2007 and 2008, including introducing competing routes to Stagecoach's 2 and 3 services in Preston's south west in 2007. The OFT therefore believes that PBL was an active and potential competitor to Stagecoach in the north and south west of Preston pre-merger.²⁰
66. Regarding the other two operators of intra-urban commercial services in Preston, Fishwicks and Blue Bus, the OFT notes that these companies operated predominantly in the south of Preston and the overlaps between their services and the merging parties' were very minor compared to the overlap between the parties. Further, as discussed in the 'Barriers to Entry' section below, both of these operators did not appear likely to enter against Stagecoach in the short to medium term.
67. In any event, as discussed earlier, given a plausible counterfactual is a purchaser of PBL's assets competing against Stagecoach, the OFT considers it plausible that, absent the merger, Stagecoach would have faced potential competition from an independent bus operator in north and south west Preston.

Conclusion on potential competition

68. The OFT therefore considers that the removal of potential

²⁰ Contrast the OFT's decision in *Completed acquisition by Stagecoach of Highland Country Buses Limited and Orkney Coaches Limited* (17 October 2008), where the OFT did not find that the merger resulted in the removal of a potential competitor from the market such as to create the realistic prospect of a substantial lessening of competition, because there was no history of actual competition in the seven years the merger parties had operated in Inverness.

competition as a competitive constraint may give Stagecoach the incentive to increase prices in the north and south west of Preston after the merger.

Alternative approach to market definition does not alter outcome of competitive assessment

69. As noted above in the 'Market Definition' section, an alternative approach to assessing the impact of the merger would be to define the market on the basis of a series of separate (overlapping and non-overlapping) flow markets aggregated into one overall market for north Preston. The parties operated commercial local bus services in Preston, with approximately [above 75] per cent market share by mileage. While the OFT does not have a share estimate for north Preston only, it considers that the share for all services is a reasonable proxy in this case. On this basis, and given its assessment of a lack of competition from other competitors (and alternative forms of transport) in the area (already discussed above), the OFT considers that the outcome of its competitive assessment would be the same when assessing the merger on the basis of an overall market for north Preston - that is, the OFT considers that the merger has or may be expected to result in a substantial lessening of competition.

Barriers to entry and expansion

70. Market enquiries revealed that a new operator wishing to run commercial bus services in Preston would be likely to require the following assets:

- a. buses and drivers
- b. the appropriate licences from the Traffic Commissioner, and
- c. access to a depot or a place to park its buses.

71. One market participant also advised that access to bus stands in good locations at the Preston Bus Station was also essential.

Buses, drivers and licences

72. With regards to a and b, above, in previous cases the OFT has found

that these usually do not constitute a barrier to entry or expansion and market enquiries confirmed this is the case in Preston.

Access to a depot

73. Stagecoach submits that there is ample land in Preston on which to establish a depot, such that depot access does not constitute a barrier to entry. Bus companies surveyed during market enquiries tended to confirm that there are suitable industrial sites available in Preston. Notwithstanding this availability of sites, the investment required for a depot of a sufficient size would be significant, and might therefore constitute a potential barrier to entry. One national operator advised the OFT that it would cost approximately £2 million to establish a depot of the size that it would need to enter the market.
74. Stagecoach also identified a number of operators with existing depots in the Preston area that could be used to support new entry. In this regard, Fishwicks advised the OFT that it had the capacity to house 20 additional buses at its sites, however, as discussed later, it also advised it would be unlikely to use this spare capacity to enter into local commercial services. The OFT was not made aware of any other competitors that had spare capacity sufficiently proximate to Preston, and of a magnitude, that would allow it to adequately replace the competition lost by the merger, however.
75. In light of the above, the OFT therefore considered that while there may be ample land on which to establish a depot in Preston, the potentially significant investment required to acquire such land and convert it into a depot of a sufficient size might constitute a significant barrier to entry; further, the evidence before the OFT is that capacity at existing depots may be limited.

Access to bus stands at the Preston Bus Station

76. One market participant, Blue Bus, suggested that it is essential for an operator to have access to sufficient stand space, in good locations, at the Preston Bus Station.
77. The Preston Bus Station is located in the centre of Preston City and has approximately 76 bays, or stands, from which buses depart.

Owing to an accident at the facility in May 2008, however, the OFT understands operating capacity of the depot is likely to be reduced for health and safety reasons. Stands are leased from the Preston City Council.

78. According to Blue Bus, Stagecoach and PBL held the leases to all the stands located in the most convenient location for passengers. While Blue Bus conceded that there are some bays left for hire, the OFT was informed that these tended to be situated away from the pedestrian subways and in some cases up to 200 metres from the Stagecoach and PBL stands, hindering an operators' ability to compete with them. Blue Bus asserts that approximately 60 to 70 per cent of journeys in Preston begin or end at the bus stand and that this lack of well-positioned bays constitutes a barrier to entry.
79. The OFT received differing accounts on both the importance of access to the bus depot and also the availability of bays. Stagecoach submitted that there are many other departure points for buses leaving Preston City. It further submitted that, based on revenue, the estimate that 60 to 70 per cent of journeys originating or terminating at the depot is likely to be over-stated and does not take into account in-bound passengers alighting before reaching the depot. In any event, Stagecoach contends that there are stands currently available for hire, many of which would be considered to be in 'prime' locations.
80. All of the merged entity's combined commercial services originate at the Preston bus station. Although these services can also be taken from bus stops nearby, this suggests that both Stagecoach and PBL considered the bus stand to be the most efficient place from which to depart their services. Nevertheless, while it may be desirable for a new operator to have access to a bus stand at the station, particularly one in close proximity to the merged entity's bays, it is unclear whether access to the station is a significant barrier to entry. The OFT notes, in particular, that Fishwicks currently operates a number of hourly commercial services in the south of Preston and only one of these originates at the Preston bus stand (the main terminus point for all routes is Fishwicks' bus depot). It is not apparent that operating services of a higher frequency, such that they compete directly with the merged entity, would require access

to a stand at the Preston bus station.

81. In light of this mixed evidence, however, the OFT cannot rule out that access to stands at Preston Bus Station may constitute a material barrier to entry.

Network effects

82. In addition to obtaining the above physical assets and licences, market enquiries also indicated other, non-tangible, barriers to entry in the form of network effects.
83. As a result of the merger, Stagecoach operates the largest network of commercial bus services in Preston.²¹ Pre-merger, both Stagecoach and PBL offered tickets on a network basis (for example, weekly tickets) and the OFT considered whether Stagecoach's network and offer of multi-trip tickets could constitute a barrier to entry.
84. In markets where a significant proportion of consumers take more than one service to reach their final destination, networks can represent a barrier to entry if new operators are required to enter on multiple routes in order to be competitive. On the other hand, the OFT accepts that network tickets can be beneficial to consumers as they can provide a convenient and cost-effective means of travel.
85. In the present case, Stagecoach submits that a very small proportion of journeys undertaken in Preston involve more than one bus. Rather, network tickets are effectively used by regular bus users as a cost effective way of purchasing multiple single tickets.²² Stagecoach advised that it undertook a survey of passengers in 2003 that showed the majority of journeys did not involve passengers changing services. In any event, Stagecoach argues that, pre-merger, it derived only [0-10] per cent of its revenue from multi-trip tickets, while PBL derived approximately [10-20] per cent.
86. To the extent that passengers use multi-trip tickets as a cost-

²¹ Fishwicks operates a small network of routes in Preston's south, most of which run on an hourly basis. Blue Bus operates two commercial services (one of which will soon cease operating) and a number of tendered ones.

²² The cost of a Stagecoach weekly ticket is approximately three and a half times the cost of a daily fare.

effective way of purchasing multiple single tickets, the OFT considers such ticketing by Stagecoach unlikely to comprise a barrier to entry. The OFT cannot identify anything in this case that would preclude a new entrant offering its own multi-trip tickets in response.

87. The OFT's market enquiries did not uncover any solid evidence regarding passengers using network tickets for more than one journey per week, although it considered it plausible that this could represent a significant part of the market, given the proportion of revenue PBL derived from network tickets.
88. The evidence before the OFT on this issue was mixed but, in any event, it did not need to conclude on whether network effects constituted a barrier to entry.

New entry and expansion

89. In light of the mixed evidence on barriers to entry described above, the OFT considered whether, in the event of a price rise or decrease in service standards or frequencies, expansion by existing Preston operators, or new entry by established operators not currently in the Preston market, would be sufficiently timely, likely and sufficient to constrain the merged entity.
90. As noted earlier, there are currently two other operators of commercial intra-urban services in Preston: Fishwicks and Blue Bus.
91. Fishwicks operates six intra-urban services in the south of Preston, although only one of these runs from Preston city centre. Most of its services operate on an hourly basis, except for the route 111 which operates every 15 minutes. Fishwicks has a depot in the south of Preston with a capacity for 60 buses. However, Fishwicks advised that, on average, it maintains a fleet of approximately 40 buses there. Although it appears well-placed to expand its services to compete with Stagecoach, Fishwicks informed the OFT that it had no plans to do so and would be highly unlikely to do so in the future, even in the event that Stagecoach raised prices and/or decreased service levels. Fishwicks advised that it is content with the size of its current operations.
92. As noted earlier, Blue Bus operates two services in the south of

Preston, the number 5 and the number 26, although the number 26 is soon to stop running.

93. Blue Bus previously operated in Manchester, where it grew its operations from approximately 10 buses in 1987 to approximately 80 buses in 2005, when it was sold to Arriva. Stagecoach submitted that Blue Bus' owner has a demonstrated history of growing local bus businesses and there is no reason why it could not do the same in Preston. Indeed, Stagecoach submitted that it has recently registered a new service in Preston.
94. The OFT does not consider Blue Bus likely to provide a sufficient competitive constraint on Stagecoach post-merger, however. First, although it has recently registered a new service, it has had to de-register one (route 26) after only six weeks in operation because it was not profitable. Second, Blue Bus cast doubts on its ability to compete effectively in the future due to the limited availability of bus stands at the bus station (discussed above). As such, Blue Bus has advised it would not be likely to expand in the event of an increase in price or decrease in service levels.
95. Other potential entrants were identified by Stagecoach and surveyed by the OFT. However, none indicated that they had plans to enter the Preston market or would be likely do so in the event that Stagecoach raised prices or reduced services in Preston. This included TransDev Blazefield, a large company with operations in nearby Blackburn and a depot in Burnley. TransDev advised that it considered Preston to be a potential market for it going forward, but that it had just completed a number of acquisitions in Blackburn and was unsure whether or when it would turn its attention to Preston.
96. Another national operator advised that it would not generally enter a market solely because prices had increased, as this could be temporary. Although it noted that a reduction in service levels may be an indicator that the market is not being adequately provided for, and therefore a potential opportunity to enter, the OFT was unable to conclude with a sufficient degree of certainty that it would be likely to enter Preston should service levels in Preston decrease.
97. The OFT was therefore unable to conclude that entry or expansion would be timely, likely and sufficient to constrain Stagecoach post-

merger.

THIRD PARTY VIEWS

98. The OFT received a comparatively high number of complaints during the course of its investigation, particularly from bus users in Preston. Although many of these complained about the conduct of the parties during the period of intense competition that occurred in late 2007 (colloquially known as the 'bus wars'), some raised concerns that, post-merger, Stagecoach had reduced frequencies on some services and altered others such that they no longer serviced some parts of the city. For example, one market participant submitted that Stagecoach has amended its number 19 service so that it no longer services Broadwood housing estate after 6pm on weekdays or on Sundays.
99. Lancashire County Council submitted that it did not expect the merger to reduce competition for tendered services in Preston. Further, it advised that it expected positive impacts, in the short term, on the routes where the parties overlapped. These benefits included later journeys on certain routes and more evenly timed services. The Council was concerned, however, that in the long term some evening and Sunday services may be deregistered leaving the Council to provide replacements.

ASSESSMENT

100. Absent the merger, the OFT considers it credible that PBL may have been able to reorganise so as to continue in Preston, albeit with a reduced number of services. The OFT does not consider it realistic that there would have been an alternative purchaser for PBL as a going concern, given that Arriva and Go Ahead were both reluctant to take on the liability for the pension scheme. However, the OFT considered that there was at least a realistic prospect that, had it not been sold to Stagecoach, and in the event it could not be reorganised, PBL would have been liquidated and its assets sold to an existing bus operator and used to run commercial bus services in Preston. The acquisition has therefore been assessed against the

prevailing conditions of competition at the time of the merger (that is, PBL's continued operations).

101. The merger has combined the two largest commercial operators in Preston. Pre-merger, the networks of Stagecoach and PBL overlapped extensively, particularly in north Preston. On approximately 120 of the flows on which they overlapped, the merger parties were the only operators.
102. Given the extensive overlap of their networks in north Preston, the OFT also considered that the merger parties were each others' most likely competitor on routes where they did not overlap in this area. Although two competitors run a small number of services in the south of Preston and could potentially expand to compete against Stagecoach, the OFT considered that potential competition concerns could not be ruled out as a result of the merger (in particular when account is taken of the fact that a realistic counterfactual to the merger was a third party acquiring PBL's assets and using them to compete against Stagecoach).
103. Access to depot space and bus stands in good position at the Preston bus station, as well as network ticketing, were examined as potentially significant barriers to entry; the evidence in relation to these points was mixed. Significantly, however, the OFT was unable to identify any operators that would be likely to enter the market in the event of an increase in rise price or decrease in service levels.
104. As such, the OFT considers 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 in the intra-urban commercial bus market in Preston.

EXCEPTIONS TO THE DUTY TO REFER

De Minimis

105. Stagecoach submitted that, were the OFT to find itself under a duty to refer, it should exercise its discretion to apply the markets of insufficient importance (or 'de minimis' exception). In line with the

OFT's published guidance,²³ the OFT will consider whether the 'de minimis' exception should be applied where the annual value in the UK of the market(s) affected by the merger is no more than £10 million.

106. Stagecoach submits that the size of the affected market is, at most, just under £5 million. This is the sum of the flow revenues derived from the parties for on- and off-bus ticket sales and concessionary fares on the eight overlap flows it identified that were not caught by the application of the CC filter.
107. Stagecoach submitted that there are strong arguments that concessionary fares should be excluded from the calculation of market size. It contends it is inappropriate to include revenue from this source because concessionary customers do not pay for travel and there is therefore no price competition between operators for these customers. However, the OFT believes that even if there were no price competition on these routes, the parties still competed on quality and frequency of services for these passengers and the OFT considers that they should, therefore, form part of the market.
108. To the extent that they are included, Stagecoach further submits that the combined revenue of the parties from concessionary fares should be discounted by 19 per cent to take into account the reduction in concessionary fares in Lancashire, effective 1 April 2009. This reduction is reflected in the above estimate. The OFT considers this reduction to be appropriate.
109. However, the OFT does not believe that the affected market in this case should be limited to the value of revenue on the overlap flows. This is because, whether on the basis of supply-side substitution or a potential competition theory of harm, the OFT believes that it is or may be the case that the merger, at least in north Preston, has resulted or may have resulted in a substantial lessening of competition.
110. On this basis, the OFT believes that the affected market should be considered to extend to all routes in the north of Preston, as well the overlapping routes in the south west of Preston, which collectively

²³ *Revision to Mergers – substantive assessment guidance Exception to the duty to refer: markets of insufficient importance* (OFT516b), November 2007.

have a value of £14 million.²⁴ Even if the market were limited to the 14 affected routes, predominantly to the north of the city, that the affected flows formed part of, the total revenue attributable to these routes is just over £10 million (including taking into account the 19 per cent reduction in revenues from concessionary fares outlined above).

111. Therefore, given that the size of the affected market in this case is greater than £10 million, consistent with its guidance, the OFT considers the present case is not a candidate for the exercise of the 'de minimis' exception.²⁵

Customer benefits exception

112. Under section 22(2)(b) of the Act, the OFT may decide not to make a reference where it believes that any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition concerned.

113. Situations where customer benefits might be weighed against an identified loss of competition are defined in section 30 of the Act as being when the merger results in lower prices, higher quality, greater choice or greater innovation. For the OFT to exercise its discretion not to refer a merger on this basis, the claimed customer benefits must be clear, timely, and merger-specific.

114. Stagecoach submitted that the merger has given rise to a number of

²⁴ Initial route revenue figures submitted to the OFT did not include revenue attributable to concessionary passengers or retail sales of bus tickets. Stagecoach submitted to the OFT that concessionary fares accounted for around [40-50] per cent of its revenue and around [50-60] per cent of PBL's revenue. Stagecoach also noted that there would be an imminent decrease in the fees received for concessionary fares of around 81 per cent. Retail sales accounted for around [0-10] per cent of Stagecoach's revenue and around [20-30] per cent of PBL's revenue. Scaling up the initial revenue figures to include concessionary and retail sales, and discounting by the reduction in concessionary fees, gave a turnover figure of £14m.

²⁵ The OFT notes that – even if the value of the affected market had been slightly below, rather than slightly above, £10 million, the OFT would not have exercised its '*de minimis*' discretion here given that the size of the market would clearly have been in the upper range of potential '*de minimis*' application; the merger would have been in the large part a '2 to 1'; there was no evidence that the effects of the merger would have been limited in duration; and there is no reason to consider that a below-average deterrent weighting should be applied in this case.

customer benefits. It submits that, post-merger, it has maintained a high frequency on all corridors; harmonised the Stagecoach and PBL networks to improve service standards; harmonised fares so that approximately two thirds of passengers are now paying less; and replaced PBL ticket machines, which did not give change, with machines that do.

115. While the OFT accepts that measures such as these can benefit consumers, the OFT has not been presented with sufficient evidence to allow it to conclude with any certainty that they outweigh the potential consumer detriment flowing from the merger. Indeed, the OFT has received some complaints suggesting the harmonisation of the networks may have caused consumer harm in some places (see 'Third Party Views', above).

116. As such, while the OFT is sympathetic to the view that this merger might indeed lead to some customer benefits, it has been provided with insufficient evidence that these benefits are clear, timely and merger-specific and that they outweigh the expected substantial lessening of competition and the adverse effects of the substantial lessening of competition.

DECISION

117. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.

Notes

- I. Arriva was not aware at the time it submitted its initial bid that it was less than the amount that PBL's owners (its employees) would be liable to pay to WMPT to make up the deficit in the fund.