



**Stena AB
and
The Peninsular and Oriental Steam Navigation
Company**

A report on the proposed acquisition of certain assets relating to the supply of ferry services on the Irish Sea between Liverpool–Dublin and Fleetwood–Larne

February 2004

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Note by the Competition Commission

The Competition Commission has excluded from this report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002. The omissions are indicated by [✂].

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Proposed acquisition by Stena AB of certain assets relating to the supply of ferry services operated by The Peninsular and Oriental Steam Navigation Company on the Irish Sea between Liverpool–Dublin and Fleetwood–Larne

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Summary

1. On 22 August 2003, the Office of Fair Trading (OFT) referred the proposed acquisition by Stena of certain assets operated by P&O on the Irish Sea to the Competition Commission (CC) for investigation and report. The reference was made under section 33(1) of the Enterprise Act 2002 (the Act). We are required to publish our final report by 5 February 2004.
2. The parties signed a Memorandum of Understanding (MoU) on 27 May 2003 setting out the arrangements for the proposed acquisition of certain assets relating to P&O's ferry operations on the Irish Sea between Liverpool–Dublin and Fleetwood–Larne and a second transaction concerning the establishment of a joint venture for port operations at Cairnryan. The possible closure of P&O's Mostyn–Dublin route was announced by P&O in its press release issued on the same day. Separate sets of conditional agreements relating to the two transactions were signed on 10 October 2003. The OFT has referred only the first transaction's two route transfers to us. Under this transaction Stena would acquire five vessels currently operated by P&O on the two routes concerned, together with related assets, inventory and goodwill. It also agreed to time charter two vessels from P&O presently deployed on its Mostyn–Dublin route.
3. We found that the share of supply test was met in respect of both the tourist and freight services provided by Stena between Great Britain and Ireland. We also concluded that arrangements were in progress which, if carried into effect, would result in the creation of a relevant merger situation.
4. Given the small impact of the proposed merger on the tourist market, our report focused on the freight market. We defined the relevant markets affected by the proposed merger to be the markets for transporting roll-on/roll-off (ro/ro) and lift-on/lift-off (lo/lo) freight between Great Britain and Ireland, first in the northern corridor (in relation to P&O's Fleetwood–Larne route) and second in the central corridor (in relation to P&O's Liverpool–Dublin route). We did not accept that these two markets should be further divided between driver-accompanied and unaccompanied freight, although we recognized the existence of two market segments.
5. Capacity utilization is generally higher for the long-sea crossings than for the short-sea crossings. We have been told that with the exception of some of the very frequent services, peak night-time services, particularly travelling from Great Britain to Ireland, tend to be fully booked or even overbooked. Since the introduction of the *Adventurer*, however, there has almost always been spare capacity on Stena's sailings between Holyhead and Dublin, including at peak.
6. Pricing in the freight ferry market is opaque. It is based on bilateral negotiations between individual customers and the ferry company concerned and results in agreed terms on specific routes. These are generally based on the previous year's prices, expectations of volumes for the coming year, and any other features specific to that particular customer. Prices may in part reflect the importance of that customer to the company as a whole, including business outside the Irish Sea. Different prices are charged for accompanied and unaccompanied traffic, and according to time of crossing. We found a high degree of variation in prices paid by individual customers. The opaque nature of this market means that ferry operators currently have the potential to price discriminate between customers.

7. It was important for customers to establish a strong relationship with a ferry operator in order to benefit from good customer service, reliability, competitive prices, and close working relationships with individual members of staff. We concluded that switching was not an endemic feature of the market and that most customers did not have sufficient countervailing buyer power to prevent the exercise of market power by ferry companies.
8. There are currently three significant ferry operators in the market for freight traffic on the northern corridor: P&O, Norse Merchant Ferries and Stena. P&O's Fleetwood–Larne route constitutes around 20 per cent of the relevant market on the northern corridor. Norse Merchant Ferries provides the most direct competition to P&O's Fleetwood–Larne route with its diagonal routes from Liverpool and Heysham to Belfast. Competition is also provided by the short-sea northern routes operated by P&O and Stena, and by Seatruck's service from Heysham to Warrenpoint.
9. As a result of the transfer of P&O's Fleetwood–Larne route, Stena's market share in the northern corridor would approximately double. Three significant ferry operators would remain, but Stena would replace P&O as the largest ferry operator on the northern corridor. The merger reduces concentration in this market, at least in the short term. Despite the removal of Stena as a potential entrant on the diagonal routes, we concluded that the transfer of the Fleetwood–Larne route from P&O to Stena could not be expected to result in a substantial lessening of competition.
10. On the central corridor, there are currently four major ferry operators. P&O has the largest market share, followed by Norse Merchant Ferries, Irish Ferries and Stena. The freight transported on P&O's Liverpool–Dublin route makes up around 20 per cent of central corridor traffic. Again the most direct competition to P&O's Liverpool–Dublin route is from Norse Merchant Ferries, which provides a similar service on the same route out of the river berths at Birkenhead, although there is also competition from all other routes into Dublin, including the short-sea route from Holyhead.
11. Post merger, the four main competitors on the central corridor would reduce to three, as P&O would exit the market, and Stena's market share would more than double. Market concentration on the central corridor would be significantly increased, and the merger would give Stena a market share significantly larger than its nearest rival. This would result in Stena having an enhanced market power which it might exercise in relation to decisions on capacity availability, on pricing, or on exploiting the 'one-stop shop' that Stena would have since, unlike its rivals, it would have a route on both the short and long central corridor crossings.
12. We considered that the Mostyn–Dublin route would close regardless of the merger. We believed that, in the absence of the merger, P&O, or an alternative purchaser of its Liverpool–Dublin route, would have a greater incentive to add capacity to capture more of the displaced Mostyn traffic than would Stena were it to acquire the route. We expected the merger to result in a reduction in capacity on the central corridor compared with the situation absent the merger.
13. We concluded, however, that, whether or not there was a reduction in capacity on the central corridor, there would be scope for Stena post-merger to exercise market power by increasing prices to certain customers. Such price discrimination would be possible given the lack of pricing transparency in the market, and the knowledge gained over time of individual customer preferences through close working relationships and the regular bargaining process. We considered that Stena would be able to focus price increases on certain customers and may also be able to increase prices to other customers, albeit to a lesser extent.

14. We expected Stena to focus price increases, post-merger, on its Liverpool–Dublin route. In addition, there would be less incentive for Stena to reduce prices at Holyhead to attract additional traffic to fill some of its spare capacity, since Stena’s Holyhead–Dublin route would capture some of the displaced traffic from Mostyn and Liverpool. We thought it unlikely that either Norse Merchant Ferries or Irish Ferries would seek to increase capacity on the central corridor to deter Stena from exercising its market power, and that the most likely independent reaction of the two main competitors would be to view any price increase by Stena as an opportunity to raise prices themselves, albeit possibly by a little less.
15. We did not believe our findings in the central corridor to be very sensitive to the definition of the relevant market for the Liverpool–Dublin route in terms of accompanied and unaccompanied freight. We recognized that the ferry operators and their customers in the two market segments might react differently to any potential price rises, but believed that, although the effects would be most applicable to the accompanied segment, there would also be some effect on the unaccompanied segment.
16. We concluded that entry was not intrinsically difficult, and that potential entrants existed who might be prepared to come into the central corridor under appropriate market conditions. However, it would be particularly important for an entrant to have access to suitable berths and sufficient surrounding land available at peak times. Further, an entrant would need to attract and retain an economically viable customer base. We therefore concluded that entry or the threat of entry within the next two to three years would not offset the possible substantial lessening of competition in the central corridor.
17. We therefore concluded that, as a result of the proposed merger, we did not expect there to be a substantial lessening of competition on the northern corridor, but we did expect there to be a substantial lessening of competition on the central corridor.
18. We did not expect relevant customer benefits as defined under the Act. We considered possible remedies which might be imposed to address the substantial lessening of competition identified.
19. We concluded that prohibiting the transfer of P&O’s Liverpool–Dublin route to Stena would be an effective remedy. The second remedy that we put forward related to facilitating access to berths at Dublin port or more generally on the central corridor. Stena proposed an enhanced package of behavioural remedies, aimed at addressing the substantial lessening of competition more comprehensively.
20. We concluded that the second possible remedy related to facilitating access to berths would not in itself enable us to form an expectation of entry occurring in a reasonable timescale and on a sufficient scale to act as a competitive constraint to Stena and hence remedy the substantial lessening of competition identified. We also concluded that the enhanced package of remedies put forward by Stena would not be effective in promoting entry that would act as a sufficient competitive constraint.
21. We therefore concluded that the action that should be taken for the purpose of remedying, mitigating or preventing the substantial lessening of competition was the prohibition of the transfer of the assets used on the Liverpool–Dublin route from P&O to Stena. Given that this would prevent the expected SLC, we did not recommend any action to be taken by others.

Findings

1. The reference

- 1.1 On 22 August 2003, the OFT referred the proposed acquisition by Stena AB of certain assets operated by P&O on the Irish Sea to the CC for investigation and report. The reference was made under section 33(1) of the Act. Our terms of reference are set out in Appendix A. We are required to publish our final report by 5 February 2004.
- 1.2 This document, together with the appendices, constitutes our final report which we are required to publish under section 38(1) of the Act. Further information, including non-sensitive versions of main party and third party written submissions, summaries of third party key arguments and views, and the reports of the two customer surveys which we commissioned, as well as our provisional findings published on 28 November 2003, can be found on our web site.¹ We cross-refer to these documents as appropriate.

2. The companies and the Irish Sea

Stena

- 2.1 Stena AB is a private company registered in Sweden and owned by the Sten Allan Olsson family. Stena AB is one of three private parent companies collectively known as Stena Sphere. Stena Sphere reported a worldwide turnover of around £1.9 billion in 2002. We use the term Stena in this report to refer to Stena AB and its subsidiary companies.
- 2.2 Stena comprises a number of different business divisions, including Stena Line, providing ferry services in and between Scandinavia, Great Britain, the island of Ireland (Ireland), the Netherlands, Germany and Poland; Stena RoRo, providing services to the ferry industry including chartering; and Stena Bulk, providing crude oil and petroleum transportation. Stena reported a worldwide turnover of approximately £0.9 billion in the year ended 31 December 2002, of which around £0.6 billion came from ferry operations. Stena's income from operations² was £80 million in the year ended 31 December 2002, of which £35 million was from ferry operations. At 31 December 2002 Stena had net assets of £0.9 billion and a gearing ratio³ of 53 per cent.
- 2.3 Stena's Irish Sea operations include ownership of two ports in the UK (Holyhead and Stranraer) and ownership of 50 per cent holdings in the ports of Fishguard and Rosslare. In relation to ferry services from Great Britain, it operates passenger and freight services to Ireland and Holland. On the Irish Sea, Stena's existing routes are Stranraer–Belfast,⁴ Holyhead–Dublin (including Holyhead–Dun Laoghaire) and Fishguard–Rosslare. These routes were acquired in April 1990 from Sea Containers Ltd, and their history dates back to Sealink (UK) Ltd.

¹www.competition-commission.org.uk.

²Total revenues less total operating expenses, before income from affiliated companies and joint ventures, financial income and expenses, minority interests, and income taxes, calculated in accordance with Swedish GAAP.

³Debt/(debt + equity).

⁴Originally operated from Stranraer to Larne.

- 2.4 Stena reported a turnover from its ports and ferries businesses on the Irish Sea of £167 million in the year ended 31 December 2002 (2001: £152 million),⁵ of which around one-quarter, £[] million, related to freight. Total earnings before interest, taxation, depreciation and amortization (EBITDA) were £[] million, a margin of [] per cent on turnover, and its return on assets⁶ was [] per cent in the year ended 31 December 2002.

P&O

- 2.5 The Peninsular and Oriental Steam Navigation Company is listed on the London Stock Exchange, and consists of P&O Ports, an international container terminal operator; P&O Ferries, including P&O Ferrymasters; and P&O Cold Logistics, a temperature-controlled logistics business. It also owns half of the container shipping joint venture P&O Nedlloyd.⁷ P&O Ferries operates ferry services between Great Britain and Ireland, France, Belgium, Holland and Spain. We use the term P&O in this report to refer to The Peninsular and Oriental Steam Navigation Company and its subsidiary companies. P&O reported worldwide turnover of £4.5 billion in the year ended 31 December 2002. At 31 December 2002 P&O had net assets of £1.3 billion and its gearing ratio⁸ was 50 per cent. At 30 September 2003, P&O's market capitalization was £1.7 billion. P&O's Ferries division reported a turnover of £1.0 billion in the year ended 31 December 2002 and an operating profit of £13.7 million.
- 2.6 The majority of P&O's current Irish Sea ferry business dates back to 1975 with the creation of its haulage/maritime services business, Pandoro⁹. P&O's current Great Britain–Ireland ferry routes are Cairnryan–Larne, Troon–Larne, Fleetwood–Larne, Liverpool–Dublin and Mostyn–Dublin. It also owns the ports of Cairnryan in Scotland and Larne in Northern Ireland. P&O also operates on two routes between Ireland and France, Cherbourg–Rosslare and Cherbourg–Dublin.
- 2.7 P&O reported a turnover from its ferry business on the Irish Sea of £107 million in the year ended 31 December 2002 (2001: £98 million),¹⁰ of which the majority, £[] million, related to freight. In total its Irish Sea business reported an EBITDA of £[] million—a margin of [] per cent on turnover. Net operating assets at 31 December 2002 were £[] million, resulting in a return on assets¹¹ of [] per cent in 2002.
- 2.8 The total turnover attributable to the routes which P&O proposes to cease operating on the Irish Sea, namely Liverpool–Dublin, Fleetwood–Larne and Mostyn–Dublin, was between £50 million and £60 million in 2002. The turnover on the Liverpool–Dublin and Fleetwood–Larne routes was of the same order of magnitude (£[] million and £[] million respectively), whereas the turnover on the Mostyn–Dublin route was somewhat smaller (£[] million).

⁵Turnover reported in Stena Line Limited's statutory accounts.

⁶EBITDA as a percentage of net operating assets employed.

⁷Not exhaustive. Also P&O Properties, containing the group's property development and investment portfolio. P&O has announced its intention to sell its 50 per cent stake in the P&O Nedlloyd joint venture to Royal Nedlloyd, in return for a cash sum and a 25 per cent stake in the new company, Royal P&O Nedlloyd NV.

⁸Debt/(debt + equity).

⁹Pandoro's haulage operation became part of P&O Ferrymasters in 1998.

¹⁰As reported in P&O Ferries (Irish Sea) Limited's statutory accounts

¹¹EBITDA as a percentage of net operating assets employed.

The Irish Sea

2.9 Figure 1 shows all major freight ferry routes on the Irish Sea. These divide into five broad groupings:

- (a) Northern short-sea routes: Services between Scotland and Northern Ireland; characterized by short crossings (between 1 hour and 4½ hours). P&O and Stena services between them provide a sailing on average every 60 to 120 minutes.
- (b) Diagonal routes: Services between north-west England and Northern Ireland. They typically take 8 to 12 hours and individual ferry operators offer a maximum of three sailings a day.
- (c) Central short-sea routes: Services between North Wales (Holyhead) and Dublin Bay (Dublin and Dun Laoghaire), offering frequent daily services taking between 1½ and 3½ hours. Between them Irish Ferries and Stena services from Holyhead offer up to ten sailings a day.
- (d) Central long-sea routes: Services between North Wales/north-west England and Dublin. These include routes from Heysham or Liverpool/Birkenhead to Dublin, as well as P&O's Mostyn–Dublin service. They typically take between 6 and 10 hours and individual ferry operators offer a maximum of two sailings a day.
- (e) Southern routes: Services between South Wales and the southern part of the Republic of Ireland.

Further details of these routes, as well as relevant industry background on economic trends, the logistics chain, types of freight and vessels, and regulatory factors, can be found in Appendix B.

Previous transactions between the parties

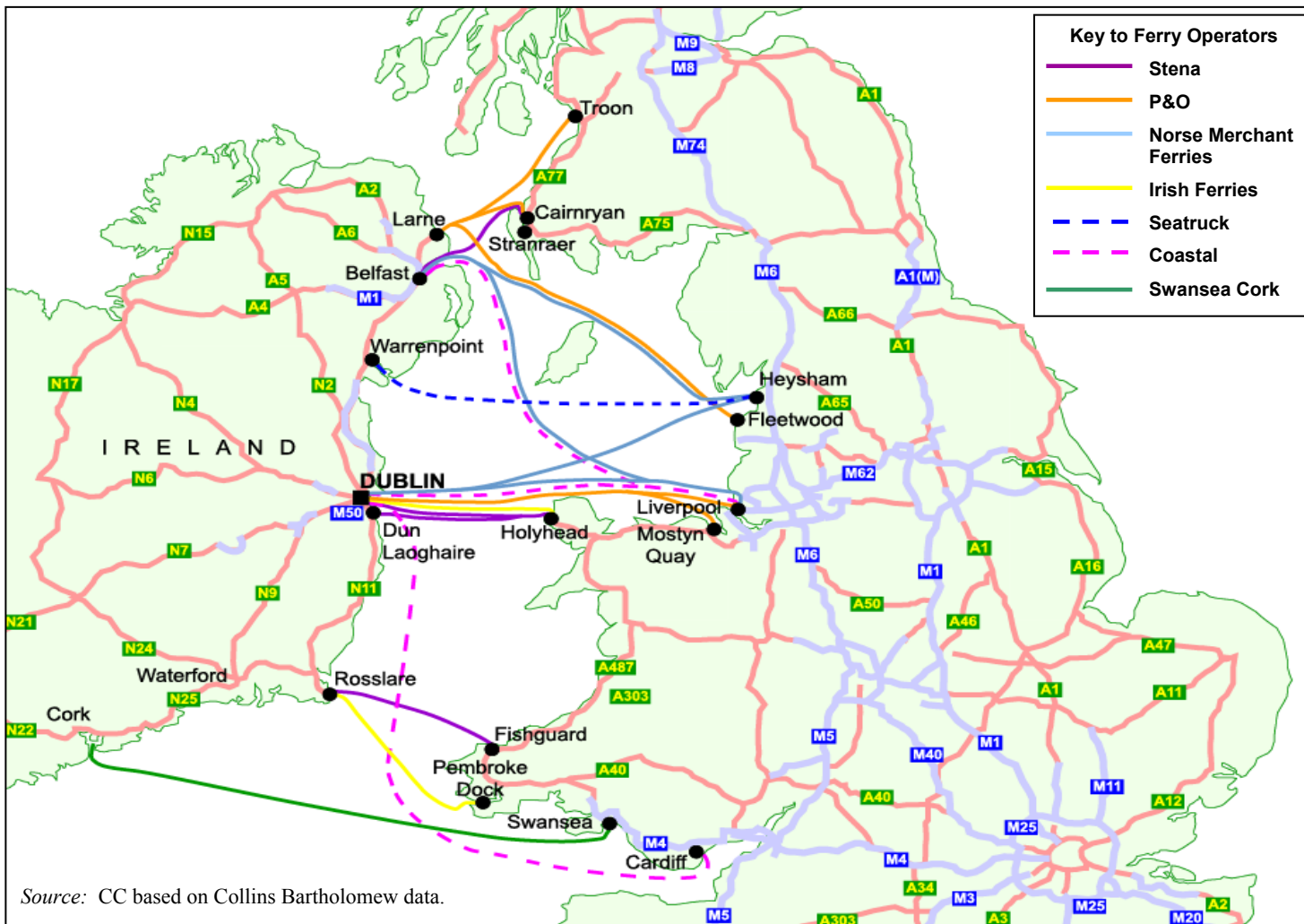
2.10 The parties told us that they had been involved in a number of high-level negotiations over the past few years.

2.11 In 1998 the parties combined their respective Dover Straits routes (Dover–Calais and Dover–Zeebrugge) into the P&O Stena Line joint venture (P&OSL). This joint venture received merger clearance from both the UK¹² and French competition authorities subject, in the UK, to a price undertaking in relation to tourist fares. Following notification to the European Commission, the joint venture was granted Article 81(3) exemption with effect from March 1998, renewed in June 2001. Stena sold its 40 per cent stake in P&OSL to P&O on 13 August 2002.

¹²*The Peninsular and Oriental Steam Navigation Company and Stena Line AB: a report on the proposed merger*, Cm 3664, The Stationery Office, November 1997.

FIGURE 1

Major freight ferry routes on the Irish Sea



- 2.12 In July 2002, P&O sold the assets (primarily three vessels) on its Felixstowe–Rotterdam route in the North Sea to Stena. P&O closed its Felixstowe–Rotterdam and Felixstowe–Zeebrugge routes in the same month, resulting in its exit from the southern North Sea. P&O continued to operate on the North Sea from Hull and Teesport. Stena used the vessels and other assets it acquired on a new Harwich–Rotterdam route.
- 2.13 In the autumn of 2002, after completion of the sale of Stena’s stake in P&OSL, discussions (which we believed started in 2000 between Stena and P&O) recommenced in relation to the possibility of Stena acquiring various P&O Irish Sea routes, including not only Liverpool–Dublin and Fleetwood–Larne, but also Mostyn–Dublin. Discussions soon focused around the first two of these routes. Stena had also put a proposal to P&O in April 2002 in relation to a possible joint development of Cairnryan, but at this time P&O was only prepared to accept part of this proposal (namely, that involving the development of a berth for Stena’s HSS vessel).
- 2.14 The parties told us that it was only after Stena announced its intention to develop a new port at Old House Point (about 1 mile from Cairnryan and nearer to the mouth of the loch) in February 2003 that P&O agreed to a revised proposal at Cairnryan to include both Stena’s HSS and ropax vessels. Stena would only acquire Liverpool–Dublin and Fleetwood–Larne, but would recognize the additional goodwill that the closure of Mostyn–Dublin would bring to the Liverpool–Dublin route. This led in turn to the MoU that is discussed in more detail in Section 3.

3. The proposed merger and relevant merger situation

Outline of merger situation

- 3.1 An MoU between Stena and P&O setting out the two route transfers (Liverpool–Dublin and Fleetwood–Larne) and arrangements at Cairnryan was agreed and signed on 27 May 2003, and a press release was issued on the same day. Separate sets of conditional agreements relating to these two transactions were signed on 10 October 2003.
- 3.2 As noted in paragraph 3.1, the MoU referred to two transactions which had been negotiated simultaneously. Under the first transaction (the Central transaction), Stena would acquire five vessels currently operated by P&O on the Liverpool–Dublin and Fleetwood–Larne routes on the Irish Sea, together with related assets and inventory. It also agreed to time charter two vessels from P&O presently deployed on its Mostyn–Dublin route. The possible closure of P&O’s Mostyn–Dublin route was announced by P&O in the press release issued on the same day. As a consequence of the route transfers, certain P&O staff would transfer to Stena, and P&O would also assign certain agreements and leases relating to port facilities, although customer contracts would not be transferred.¹³ P&O would agree not to operate passenger or freight ferry services on Liverpool–Dublin, Fleetwood–Larne, or any route from the port of Mostyn for a period of [X] years from completion. The OFT has referred only the Central transaction’s two route transfers to us. The parties both gave us assurances that this transaction would not be completed until the deal had received clearance from the relevant competition authorities. The Central transaction was notified to the Irish Competition Authority on 7 November 2003. The Irish Competition Authority announced on 4 December 2003 that it

¹³There are no formal written contracts between ferry operators and customers.

would carry out a Phase 2 investigation. It has until 5 March 2004 to make its decision on the transaction.

- 3.3 Under the second transaction (the Cairnryan transaction), Stena and P&O would establish a joint venture company (JV). The JV would purchase P&O's port assets and operations at Cairnryan and then oversee the financing and construction of new berths, with the intention of P&O and Stena both operating ferry services from Cairnryan. Stena would then cease operations from Stranraer. After the development of the Cairnryan port, the role of the JV would be limited to ensuring safe navigation at the port, and maintaining port infrastructure and security.
- 3.4 We noted that there were contractual links between the Central and Cairnryan transactions and between the Central transaction and the closure of the Mostyn–Dublin route. In the signed agreements, the total consideration estimated at between £75 million and £85 million is structured as a payment for the five vessels and port assets on the two routes to be transferred of approximately £[redacted] million, a £[redacted] million payment expressed as a contribution to the costs P&O will incur to close its operations at Mostyn and Fleetwood, and a contribution of £[redacted] million towards the land and port assets to be transferred to the Cairnryan JV.¹⁴ The parties told us that of the £[redacted] million payment expressed as a contribution towards closure costs, almost half related to the Cairnryan transaction (reflecting an upfront payment from Stena for port dues) and the remainder related to goodwill on the Central transaction. Further details are set out in Appendix D. The parties told us that this structure had been designed to optimize P&O's cash flow and that although the transactions had to be considered together to understand the financial arrangements, they were not interdependent.
- 3.5 We concluded that the Central and Cairnryan transactions were capable of proceeding independently. We also concluded that although the closure of the Mostyn–Dublin route was inextricably linked with the Central transaction, the route was uneconomic and would be expected to close in any event (see paragraph 5.32).

The rationale for the merger

- 3.6 Stena told us that ferry operations were its core competence. It said that its strategy for the Irish Sea was to extend the range of services it offered to its customers, in particular offering more unaccompanied services, and to continue to invest as and when suitable opportunities arose. Stena stated that the acquisition of P&O's Fleetwood–Larne and Liverpool–Dublin routes would enable it to offer a greater choice of routes to its freight customers as well as the opportunity to use overnight services for traffic to and from Dublin and Larne. After completion of the transaction, Stena would have six routes on the Irish Sea, with sailing frequencies of 20 to 25 departures a day, doubling its existing freight capacity.
- 3.7 Stena said that the removal of the Mostyn–Dublin capacity would result in additional traffic on P&O's Liverpool–Dublin route and on its own Holyhead–Dublin route and would improve the viability of its Irish Sea business post-merger. Stena expected EBITDA on the two routes it was taking over to be around £[redacted] million in 2004 (£[redacted] million after capital costs¹⁵), plus an increase in EBITDA of £[redacted] million in 2004 on its existing Holyhead–Dublin route as a result of the Mostyn–Dublin

¹⁴To be paid indirectly via port dues.

¹⁵Notional capital costs including interest, calculated according to Stena's internal management accounting policy.

closure. In addition, Stena wished to link payments for the route transfers to the arrangement at Cairnryan, in order to incentivize P&O to proceed with Cairnryan as quickly as possible.

- 3.8 Stena did not anticipate significant cost synergies as a result of the transfer of routes, although there were significant cost savings associated with the Cairnryan development in comparison with the alternative plan to develop a new port at nearby Old House Point.
- 3.9 P&O said that the overall deal reflected its decision to rationalize its activities on the Irish Sea because of the inadequacy of current and anticipated returns compared with those it could achieve elsewhere in the group. In particular, it said that the returns it achieved from its container terminals business (P&O Ports) were significantly higher than those of its ferries business.
- 3.10 P&O also said that the two transactions represented a restructuring of its Irish Sea business which would allow it to focus on higher-yielding routes, in line with its strategy to focus on passenger routes with a strong freight underlay.
- 3.11 P&O said that the transactions were structured to generate certain financial benefits. [



]

- 3.12 As the parties have explained, the two transactions were originally conceived as part of Stena's and P&O's respective strategies for their Irish Sea ferry services. The parties said that the transactions were now structured in a way that they could proceed independently of one another. This report only covers the Cairnryan transaction to the extent necessary to understand the Central transaction. We believe the closure of the Mostyn–Dublin route to be inextricably interwoven with the Central transaction, and to form part of the rationale for the transfer of the two routes.
- 3.13 It has also been put to us by several third parties that these transactions are part of Stena's and P&O's wider strategies for ferries generally. Some argue that P&O will withdraw entirely from the Irish Sea over the next two to three years, in return for Stena having sold its stake in P&OSL in 2002. The parties vigorously deny this. In any event, our terms of reference require us to consider only the effects of the proposed merger.
- 3.14 Shortly after the reference was made to us, the European Commission independently launched an investigation into alleged fixing of prices and trading conditions for cross-channel transport services and suspected market-sharing agreements in relation to the provision of ferry services to and from the UK. The timescale for the European Commission's investigation extends well beyond the timescale of this inquiry, and we have not allowed the fact of the European Commission investigation to influence our decision in this merger inquiry.

Jurisdiction

- 3.15 Under our terms of reference (see Appendix A), we are required to investigate and report on whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation. Under the Act there are a number of considerations relevant to determining whether there is a relevant merger situation:
- (a) whether two or more enterprises cease to be distinct; and
 - (b) whether either the turnover test or share of supply test is satisfied.
- 3.16 In terms of (a), an 'enterprise' is defined as the activities or part of the activities of a business (section 129(1) of the Act). Although the contractual documentation focuses on the purchase of assets and charter of vessels, certain factors, including the non-compete clause between the two companies and the transfer of certain P&O staff, led us to conclude that the deal is one in which two or more enterprises cease to be distinct. The parties agreed with this view.
- 3.17 We noted that the closure of the Mostyn–Dublin route would not amount to a merger situation under the Act. The arrangements at Mostyn are relevant, however, when considering the counterfactual against which the merger should be assessed, as discussed further in paragraphs 5.24 to 5.32.
- 3.18 The share of supply test is satisfied if, as a result of the merger, the following condition prevails or does so to a greater extent:
- In relation to the supply of services of any description, at least one-quarter of all the services of that description which are supplied in the UK, or in a substantial part of the UK;
- (a) are supplied by one and the same person or are supplied to one and the same person; or
 - (b) are supplied by the persons by whom the enterprises concerned are carried on, or are supplied to those persons.
- 3.19 Tables 5 and 6 of Appendix F show that the share of supply test is met in respect of both the tourist and the freight services provided by Stena between Great Britain and Ireland, both in aggregate and individually. The parties agreed with this view. We are therefore not required to consider whether or not the turnover test is met.

Conclusions on relevant merger situation

- 3.20 For the reasons set out in paragraphs 3.15 to 3.19, we therefore conclude that arrangements are in progress which, if carried into effect, will result in the creation of a relevant merger situation.

4. Market definition

- 4.1 There are a number of dimensions to the definition of the relevant markets. We consider first a number of aspects of the product transported (tourist vs freight traffic, and types of freight traffic), and then discuss the appropriate level of geographic aggregation of routes. In coming to our view of market definition we

have followed the CC guidelines and have taken into account the parties' views on market definition, as well as third party views and the results of our two surveys. See Appendix H for further details of the methodology underlying our two surveys.

Tourist vs freight

- 4.2 The key sources¹⁶ of demand for ferry transport on the Irish Sea are:
- (a) tourist (including foot passengers and private cars with their drivers and passengers); and
 - (b) freight (driver-accompanied and unaccompanied ro/ro and lo/lo; see Appendix B for more details).
- 4.3 From a demand perspective, tourist and freight services are very different. Tourist demand is seasonal, being concentrated in the summer months, on the shorter sea crossings, and during the day. Freight demand is driven primarily by the strength of the Irish economy. It is much more constant during the year, although volumes increase from September to the third week of December, in the run-up to the festive season. Westbound flows are often supplies of components and retail goods into Ireland; eastbound flows are primarily of agricultural and manufactured products out of Ireland. This freight demand is particularly high on evening and night-time crossings, for delivery early the following day, especially in the westbound direction, ie late night crossings from Great Britain arriving in the Dublin or Belfast areas for early morning deliveries.
- 4.4 Both Stena and P&O carry tourist traffic as well as freight. However, tourists account for less than 10 per cent of revenue on each of the two routes to be transferred, and on the Mostyn–Dublin route, and in total these routes represent a very small proportion of total tourist ferry traffic to Ireland. As shown in Appendix F (see Table 5), Stena is the market leader in respect of tourist traffic on each of the three corridors in the Irish Sea (northern, central and southern). The merger only slightly increases its market share, whether considered on an individual corridor or on an aggregate basis.
- 4.5 Taking account of the different demand characteristics of passenger and freight services set out in paragraph 4.3, we conclude that tourist and freight services constitute separate markets. Given the small impact of the proposed merger on the tourist market, this report will focus on the freight market. The OFT also concluded that the P&O tourist services to be acquired by Stena were unlikely currently to represent a significant competitive constraint on Stena and hence would not significantly alter the competitive situation with regard to tourists.

Types of freight

- 4.6 It is useful first to understand the ferry journey in the context of the overall freight journey. The ferry companies' operations form part of a logistics chain from the original consignor of the goods to the ultimate recipient. Consignors range from large-scale distributors of goods, such as manufacturers and supermarkets, with highly-developed distribution planning functions, to small companies that may not

¹⁶In addition, there is demand from trade cars. The majority of trade cars are imported directly from the Continent to Ireland on specialized vessels; trade cars carried on ferries are primarily those assembled in Great Britain.

be able to ship a complete lorry load of goods. The way that consignors use ferries and road transport depends on a number of factors including the nature of the goods being transported. Consignors of perishable goods, for example, will often set rigorous specifications for the times that goods are to be collected and delivered, with the objective of minimizing stock levels and ensuring that their outlets are supplied on a 'just-in-time' basis. The choice of ferry route or mode of transport (including driver-accompanied or unaccompanied—see paragraph 4.9) is only one element in the decision as to how best to meet these requirements. Although the consignors of the goods are the ultimate customer for ferry services, the ferry companies' primary customers are often the hauliers. Other primary customers include intermediaries who help smaller consignors and hauliers to plan and carry out their distribution activities. In the remainder of this report, we use the term customer to refer to the primary customers of the ferry companies. See Appendix B, paragraphs 4 to 7, for more details.

- 4.7 Freight may be transported across the Irish Sea by air or by sea, and the sea journey may be made in a variety of types of vessels including ro/ro, lo/lo and bulk carrier. Our surveys and evidence that we have taken from third parties consistently confirmed that neither air freight nor bulk shipment were economic alternatives to ro/ro and lo/lo for more than a very limited amount of freight, and on the basis of this evidence we conclude that these do not form part of the same market.
- 4.8 Unitized freight can be carried in lorries and trailers on ro/ro services or in containers on lo/lo services. Containers to be carried on lo/lo vessels are lifted on and off by special-purpose cranes. P&O provides a lo/lo-type service on its ro/ro ferries on its Liverpool–Dublin route which competes with dedicated lo/lo operators by placing containers on special trailers. Lo/lo door-to-door services may compete with hauliers using ro/ro services and are thus a potential substitute for less time-sensitive freight. We received little information on the extent of competition between lo/lo and ro/ro, though we understand that there is at least one example of lo/lo services taking business from ro/ro. Given the potential substitutability of lo/lo for ro/ro as evidenced by this example and the fact that P&O itself provides a lo/lo-type service, we have included lo/lo in the same market. We do not, however, expect lo/lo to provide a major competitive constraint on ro/ro.
- 4.9 A further issue was whether the freight ferry market should be subdivided into accompanied and unaccompanied services. Accompanied freight is unitized freight carried on a vehicle with its own traction, typically a lorry or an articulated vehicle, accompanied by a driver. Unaccompanied freight travels on the ferry without a traction unit or a driver, typically either on a trailer or in a rigid container. The choice of mode of ferry transport also has a wider impact on the total cost of the overall freight journey. Accompanied traffic, for example, ties up a driver for the duration of the journey; unaccompanied traffic requires a greater initial investment in terms of depots and other infrastructure, as dictated by the requirements of the consignor. The parties argued that the key characteristics of the two modes differed markedly. They told us that accompanied freight was generally time-sensitive, requiring delivery on the following working day. It often comprised next-day (morning) deliveries for supermarkets or other retailers, perishable goods, parcels, groupage,¹⁷ or high-value goods with particular security requirements. Reliability was key for this type of freight. Accompanied freight tended to be

¹⁷'Groupage' refers to a haulier collecting a number of part-loads which are then transported as a single trailer load.

handled by smaller road-hauliers, as such hauliers did not participate in the more logistically complex unaccompanied market, other than on an occasional basis. The parties also told us that accompanied freight hauliers had greater flexibility in determining their route, but often favoured the shorter sea crossings with their later departure times. They also told us that an accompanied service attracted a price premium compared with an unaccompanied service.

- 4.10 In contrast, the parties told us that unaccompanied freight was generally not used for next-day deliveries. It would not usually travel on higher-cost peak sailings, but would be transported on lower-cost daytime and weekend sailings. It was less suitable for perishable goods and groupage, and tended to be tied to a limited range of ports because of the substantial organizational infrastructure required. This included an administration/ordering/logistics centre and a depot for a fleet of traction units and trailers, which needed to be situated close to the port and industrial area that it served. The parties told us that hauliers tended to operate exclusively in accompanied or unaccompanied mode due to the different operational characteristics of the two modes of transport.
- 4.11 We found evidence of a variety of practices, and, in particular, unaccompanied freight being used fairly extensively for next-day delivery, for perishable goods, for parcel delivery, for groupage, and travelling on peak and short-sea crossings—characteristics the parties generally attributed to accompanied freight:
- (a) Several, but not all, major food retailers used either an unaccompanied service or a mixture of unaccompanied and accompanied services to supply perishable goods on ferries to Ireland for next-day delivery.
 - (b) Many hauliers said that an unaccompanied service was used to provide a next-day or even next-morning service, not only for retailers, but also for groupage and parcels. They estimated the additional time at the port required for loading and unloading to be of the order of 60 to 90 minutes, which could be built into the required delivery schedule.
 - (c) Security issues were sometimes dealt with by setting up secure areas at each port, rather than sending freight with a driver. A major haulier told us of computer components and finished products that were shipped unaccompanied between Holyhead and Dublin.
 - (d) Around half of peak night-time traffic on Liverpool–Dublin, Fleetwood–Larne and Mostyn–Dublin was accounted for by unaccompanied traffic, despite peak crossings generally being associated with accompanied freight.
 - (e) Although Stena’s Holyhead–Dublin short-sea route carried almost exclusively accompanied traffic, the parties told us that around one-quarter of Irish Ferries’ traffic on that route was unaccompanied freight.
- 4.12 Many large hauliers have a division specializing in each of the accompanied and unaccompanied modes, and we believe that they would have few difficulties in shifting the balance of their work. Our quantitative survey (the ORC International (ORC) survey) showed that around one-third of those interviewed carried a mix of accompanied and unaccompanied freight. Unaccompanied hauliers are able to accept accompanied business and many do so. On the other hand, there are undoubtedly a large number of smaller hauliers carrying out an accompanied operation that would be unlikely to shift to an unaccompanied operation, other than on an occasional basis. A large-scale shift from accompanied to unaccompanied

operations is not straightforward and might require a change in infrastructure. This could take several months to achieve, and would only be worth doing if the circumstances giving rise to the change were expected to prevail over a longer period. Finally, even if individual hauliers found it difficult to shift between offering accompanied and unaccompanied services, users of haulage services, such as retailers, would be able to switch from accompanied to unaccompanied services simply by switching between service providers. This might require reorganizing their logistics and, in all likelihood, investing in some warehousing or storage facilities. We decided, however, that these investments were not so large as to rule out the possibility of switches occurring within a matter of months were circumstances to favour such a shift.

- 4.13 Substitution also occurs on the supply side. We believe that some ferry operators primarily focused on providing an unaccompanied service would be able to provide more accompanied spaces in response to a price rise by a hypothetical monopolist supplier of an accompanied service. To the extent that unaccompanied ferry operators were using vessels with limited driver accommodation, they could still supply some accompanied spaces immediately, and would be able to increase the accompanied spaces further in considerably less than one year by chartering vessels with more accommodation for drivers.¹⁸ In most cases, we expect that accompanied ferry operators could provide unaccompanied spaces in response to a price rise by a hypothetical monopolist supplier of an unaccompanied service, at least at the margin.
- 4.14 The parties argued that the existence of a price difference between accompanied and unaccompanied freight ferry services supports the view that these are separate markets. We note that, in principle, two products differing in one or more characteristics that give rise to a clear and stable price difference may still be in the same market, providing a competitive constraint on one another.¹⁹ In the case of accompanied and unaccompanied freight ferry services, prices are probably best compared when expressed in 'lane metres' (the measure of capacity for vessels carrying ro/ro vehicles). On average, the price difference tends to be greater than can be accounted for by difference in vehicle length (unaccompanied loads, without a traction unit, are shorter and therefore cheaper). However, we found it difficult to interpret the observed difference in average price between accompanied and unaccompanied services paid on particular routes for two reasons. First, although Appendix G compares average prices for peak and off-peak sailings separately, price differences may still to some extent reflect the mix of accompanied and unaccompanied traffic (unaccompanied customers tend to be larger with a stronger negotiating position and paying lower prices). Second, prices also reflect the additional costs for accompanied freight associated with driver accommodation and food, and, for unaccompanied loads, the costs of loading and unloading the vessel. Overall, while noting the price differential in the two modes of ferry service, we did not believe that there was sufficient evidence to suggest that there were separate markets for accompanied and unaccompanied ferry services.
- 4.15 The parties responded to our suggestion that the two modes of transport may not constitute separate markets. In addition to the arguments already made in paragraphs 4.9, 4.10 and 4.14, they highlighted the following:

¹⁸As set out in Appendix B paragraph 36, freighters carrying 12 or fewer passengers have reduced manning and other regulatory requirements which give them significant operating cost advantage over other types of ro/ro vessels.

¹⁹This would be the case if a widening of the price differential beyond that justified by the difference in product characteristics led to a substantial switch in demand between the two.

- (a) Customers were still prepared to use the more expensive accompanied mode of transport, and Stena and Irish Ferries had both invested substantially in new capacity designed primarily for the accompanied market. This suggested that many customers saw additional value in an accompanied service.
 - (b) The increased speed and reliability of the accompanied service was the key differentiating factor between accompanied and unaccompanied.
 - (c) Whilst switching was possible for small volumes of freight, entry into the high-volume unaccompanied business would require considerable up-front investment in logistics, drivers, premises, and above all, trailers.
- 4.16 These arguments did not, for the reasons set out in paragraphs 4.11 to 4.14, change our view that, regardless of the different characteristics associated with the accompanied and unaccompanied freight ferry services, they represented a strong competitive constraint on one another and hence formed part of the same market. The parties also acknowledged that they did not believe the market definition with regard to accompanied and unaccompanied freight to be critical to the overall conclusion on the effects of the proposed merger, provided the distinction between the two types of freight was recognized fully.
- 4.17 Having taken account of the parties' arguments, for reasons set out in paragraphs 4.11 to 4.16, we conclude that we should treat accompanied and unaccompanied services as a single market. We recognize, however, the existence of two market segments, and believe that, due to the different nature of accompanied and unaccompanied operations, there may be some differences in the reaction of ferry operators and their customers in each of these segments to market events.

Routes

- 4.18 The parties said that in their view the overwhelming competitive pressure was head-to-head rivalry on a particular route, which they said would be unaffected by the merger. Thus, for example, with regard to the central routes, the commercial decisions taken by Stena relating to its Holyhead–Dublin route were, they said, primarily driven by competition against Irish Ferries; similarly, Norse Merchant Ferries was said to provide the head-to-head competition to P&O on the Liverpool–Dublin route.
- 4.19 The parties said that the importance in competition terms of interaction across routes was secondary to this head-to-head rivalry. To the extent that it was relevant, the parties viewed the appropriate groupings of routes as being determined by the different characteristics of accompanied and unaccompanied freight. This led them to argue that the market for accompanied freight should be defined as the Irish Sea as a whole, largely on the basis that a driver-accompanied vehicle has a high degree of flexibility in choosing its ports of origin and destination, and can, if necessary, use indirect routes (for example, going to Dublin via Belfast). For unaccompanied freight, due to the constraints caused by the substantial organizational infrastructure required, the parties argued that a number of narrower markets should be defined:
- (a) In the case of unaccompanied freight from England and Wales:
 - (i) long-sea central corridor routes (including Liverpool–Dublin), serving Dublin and its hinterland;

- (ii) short-sea central corridor routes (including Holyhead–Dublin), serving Dublin and its hinterland; and
 - (iii) long-sea diagonal routes (including Fleetwood–Larne) and short-sea Scottish routes serving Belfast and its hinterland.
- (b) In the case of Scottish corridor freight, short-sea Scottish routes serving both Belfast and its hinterland and Dublin and its hinterland.
- 4.20 The parties also argued that there was no obvious second-best alternative to the preferred route for the minority of accompanied traffic on the central corridor which would choose to switch in response to a price rise of 5 to 10 per cent (see paragraph 4.23). As regards unaccompanied traffic, they considered the relevant geographic markets for the Liverpool–Dublin and Holyhead–Dublin routes to be separate.
- 4.21 We started by considering each of the two routes (Liverpool–Dublin and Fleetwood–Larne) as separate markets, and then extended our market definition as far as was necessary to reach a conclusion. A market may be widened either because of demand-side (customer) substitution or supply-side (ferry operator) substitution. We consider demand-side substitution in paragraphs 4.22 to 4.27. We consider that the issues associated with supply-side substitution, which occurs if a price rise prompts other firms to start a service at short notice with existing facilities, are similar to those associated with market entry and these are discussed in paragraphs 5.52 to 5.61.
- 4.22 Our two surveys, as well as evidence from third parties, suggested that location of ports, relative to the origin and destination of the goods and any depots, was only one, albeit key, factor affecting customers’ choice of routes. Other important factors included the availability of timely crossings, the reliability of the crossings, road and ferry costs, the operational relationship between the customer and the ferry company, and the drivers’ facilities and comforts. This suggests at least some willingness to substitute between ports by customers, and the surveys yielded more information on preferred alternatives to the routes which form the subject of this inquiry.

Liverpool–Dublin

- 4.23 The results of the ORC survey did not support the narrowest possible market definition of Liverpool²⁰–Dublin. We asked the 84 regular users of P&O’s Liverpool–Dublin route and the 119 regular users of Stena’s Holyhead–Dublin route who responded to the ORC survey, whether they would switch routes in response to a potential 5 per cent price rise. If they said that they would switch (switchers), they were asked how much traffic they would re-route and to which route; if they said that they would not switch (non-switchers), they were asked which would be their preferred alternative if they were unable to use that route and ferry operator. We received the following responses (detailed further in Appendix F, Table 10 and paragraph 22, and Appendix H):
- (a) P&O’s Liverpool–Dublin route: Overall, both switchers (constituting around one-third of regular users) and non-switchers considered Stena’s Holyhead–Dublin

²⁰In referring to Liverpool, we are also including the river berths used by Norse Merchant Ferries at Birkenhead; Liverpool should therefore be taken as referring to all routes from Merseyside.

route to be at least as strong an alternative to P&O's Liverpool–Dublin route as was the head-to-head competitor Norse Merchant Ferries' Liverpool–Dublin route.

- (b) Stena's Holyhead–Dublin route: On this route, both switchers (again constituting around one-third of regular users) and non-switchers considered the strongest alternative to be the head-to-head competition from the Irish Ferries service on the same route, but many also referred to P&O's Liverpool–Dublin route.

The relative strength of Stena's Holyhead–Dublin route as an alternative to P&O's Liverpool–Dublin route is supported by the results of our qualitative survey (the Andrew Irving Associates (AIA) survey), which showed that respondents saw P&O and Stena as offering a higher quality of service than other ferry companies (see paragraph 5.7).

- 4.24 The survey results also suggested that, despite the northern and southern corridor routes occasionally representing a viable alternative to P&O's Liverpool–Dublin route, they were in general a much less strong alternative than the central corridor routes (see Appendix F, Table 10). This result is supported by the analysis included in Tables 1A to 2B of Appendix H, which shows that the alternatives to Stena's Holyhead–Dublin and P&O's Liverpool–Dublin routes primarily fall within the central corridor. We consider that a hypothetical monopoly provider of ferry services in the central corridor could profitably impose an average 5 per cent price rise.

- 4.25 We noted other arguments consistent with defining the market as the central corridor:

- (a) Stena's own management papers showed that it considered the competitors to its Holyhead–Dublin crossings to include not only Irish Ferries, but also P&O and Norse Merchant Ferries.
- (b) In Stena's notification of the merger to the OFT (approved by P&O), the post-merger market shares assumed that the Mostyn traffic was distributed pro-rata to the existing market shares of the remaining central corridor ferry operators. Furthermore, Stena's financial modelling of the redistribution of the Mostyn–Dublin traffic made the broadly similar assumption that the traffic would be redistributed between Holyhead–Dublin and Liverpool–Dublin. These assumptions were made despite the parties' views on market definition (see paragraphs 4.19 and 4.20).
- (c) The parties gave us a number of examples of customers who had switched business on the central corridor. The examples originally given to us by P&O focused on customers who had switched business between Stena's Holyhead–Dublin route and P&O's central corridor routes (Liverpool–Dublin and Mostyn–Dublin); only two of the 12 referred to Norse Merchant Ferries' Liverpool–Dublin route as a possible substitute. P&O later gave us six examples of unaccompanied customers who had switched to Norse Merchant Ferries' route. Stena also included several examples of business being lost from its Holyhead–Dublin route to P&O's central corridor routes, although the majority of its examples focused on business gained or lost to Irish Ferries.
- (d) The central corridor is a term widely used within the industry. Third parties, in their evidence to us, often referred to a central corridor market, to central

corridor routes, or to middle routes (to/from Dublin Bay). In our view this is consistent with the view that substitution is more likely between central corridor routes than with routes outside the central corridor.

- 4.26 In view of the discussion in paragraphs 4.18 to 4.25, we decided that the relevant geographic market for the Liverpool–Dublin route was the central corridor and that the market should not be widened further.

Fleetwood–Larne

- 4.27 The closest alternatives from a geographical viewpoint to P&O’s Fleetwood–Larne route are the other diagonal routes, including: Norse Merchant Ferries’ two crossings—Liverpool–Belfast and Heysham–Belfast; and Seatruck’s Heysham–Warrenpoint route. Our survey results suggested that the shorter Loch Ryan²¹ crossings to Northern Ireland were regarded as substitutes for diagonal crossings terminating in Northern Ireland; and certainly were better demand-side alternatives to P&O’s Fleetwood–Larne route than were the central or southern routes (see Appendix F, Table 9). This view was reinforced by evidence from some ferry operators (see paragraph 5.61(a)). On the basis of demand-side substitution, we therefore consider that the geographic market in which P&O’s Fleetwood–Larne route competes should be the northern corridor, including both the diagonal and the Loch Ryan crossings, but that this market should not extend to either the central or the southern corridors.

Conclusions on market definition

- 4.28 In conclusion, we defined the relevant markets affected by the proposed merger to be the markets for transporting ro/ro and lo/lo freight between Great Britain and Ireland, first in the northern corridor (in relation to P&O’s Fleetwood–Larne route) and second in the central corridor (in relation to P&O’s Liverpool–Dublin route). We do not accept that these two markets should be further divided between accompanied and unaccompanied freight, although we recognize the existence of two market segments.

5. Assessment of the competitive effects of the merger

- 5.1 This section of the report discusses the competitive effects of the merger having regard to the CC guidelines.²² We first outline briefly some key features of the existing competitors in the market, and then discuss a number of underlying factors affecting existing rivalry in the relevant markets, including capacity and utilization, market concentration, and pricing. Following a discussion of the counterfactual, we discuss the effects of the merger, and finally discuss whether market entry might mitigate these effects. This leads to our conclusion about whether or not we expect a substantial lessening of competition (SLC) as a result of the proposed merger. Unless otherwise specified, the effects discussed apply to the relevant markets defined in Section 4.

²¹Loch Ryan includes the ports of Cairnryan and Stranraer.

²²CC2—*Merger References: Competition Commission Guidelines*, June 2003.

Existing competitors

- 5.2 There are four major freight ferry companies operating on the Irish Sea: Stena, P&O, Norse Merchant Ferries and Irish Ferries. In addition, there are a number of smaller ferry operators, including Seatruck, which provides a two-ship ro/ro freighter service between Heysham and Warrenpoint, and Coastal, which provides a lo/lo service between Liverpool and Ireland (Dublin and Belfast).
- 5.3 A brief overview of Stena and P&O was given in paragraphs 2.1 to 2.4 and 2.5 to 2.8 respectively. Stena told us that it was a company committed to operating ferries in the long term, with a strong European network. It owned a charter business, and had considerable flexibility in its deployment of vessels on routes around the UK and Scandinavia, giving it the ability to open up routes or make changes in capacity relatively quickly. Being privately owned, it was not subject to short-term stock market pressures. Stena told us that it had invested in IT systems and ran a centralized booking service.
- 5.4 P&O told us that its strategy was to reduce its presence in relatively less-profitable areas and focus on businesses with a higher return across the globe, particularly container terminals. In relation to ferries, P&O had made known its intention to withdraw from less-profitable routes and focus on passenger routes with a strong freight underlay, where it had recently invested heavily.
- 5.5 Irish Ferries is the main Irish shipping company operating in the Irish Sea. It is a subsidiary of Irish Continental Group plc, listed on the London and Dublin Stock Exchanges. We have been told that it has a good reputation and has invested substantially in ferry operations over recent years, and in particular now owns the largest vessel on the Irish Sea, the *Ulysses*, operating between Dublin and Holyhead. Irish Ferries is not present on any other route on the central or northern corridors (it has a route in the south, Pembroke–Rosslare, as well as two services from Ireland to France). With regard to the relevant markets, it therefore currently provides competition in the central corridor, in particular to Stena’s Dublin–Holyhead route.
- 5.6 Norse Merchant Ferries is the trading name of Merchant Ferries plc and Norse Irish Ferries plc. Until recently, they were the major operating subsidiaries of Cenargo International plc, a privately-owned shipping group. Following defaults on bond covenants issued in the USA, Cenargo was placed into administration in February 2003, but a debt for equity swap had now been agreed and the shipping subsidiaries emerged from administration in December 2003 under a new company, Norse Merchant Group Limited. We understood that the restructuring had significantly reduced the debt burden of Norse Merchant Ferries and was therefore likely to provide some stability, at least in the short term. In addition, a new Group Managing Director had been appointed. However, we understood that the next three to five years would be critical for the long term survival of the company. [



] (see Appendix J for further details). Norse Merchant Ferries’ strategy is based on hub operations, providing a service between England (Liverpool (Birkenhead) and Heysham), and Ireland (Dublin and Belfast). It is generally considered to have access to some excellent port facilities, and some good vessels. In particular, Norse Merchant Ferries operates from the new river berths at Birkenhead, thus avoiding the additional 30 minutes required to access Liverpool docks with its system of locks. During the administration process, it had

reduced capacity on its Heysham–Belfast service as well as reducing accompanied capacity on its Liverpool–Dublin route (see Appendix F), although the frequency of sailings had been increased on its Liverpool–Belfast route. Norse Merchant Ferries provides the closest direct competition to the two routes to be transferred—head-to-head competition to P&O’s Liverpool–Dublin route, and competition to P&O’s Fleetwood–Larne route from its two routes to Belfast from Liverpool and Heysham.

- 5.7 As noted in paragraph 4.23, the AIA survey results show that customers tend to consider Stena and P&O to be the market leaders, providing the best service on the Irish Sea. This was because they were generally seen as more reliable, their vessels were widely perceived to be larger and faster, their booking systems were often seen as more convenient, their staff were well respected, and they were often viewed as older and more established companies (see section 2.3, AIA Survey Report). There was also generally considered to be a small price premium associated with these two companies. Irish Ferries and, in particular, Norse Merchant Ferries, were regarded as being less reliable than either Stena or P&O. Other constraints from these two competitors included the limited choice of routes on offer from Irish Ferries and the need for Norse Merchant Ferries, having recently emerged from administration, to meet the objectives of its new shareholders.

Underlying factors affecting existing rivalry in the relevant markets

Capacity and utilization

- 5.8 Ro/ro capacity on the Irish Sea has increased significantly since 1996, particularly on the central corridor. All of the major competitors have contributed to this increase: Norse Merchant Ferries introduced a Liverpool–Dublin service in 1999, both Irish Ferries and Stena expanded capacity on the Holyhead–Dublin route,²³ and P&O started the Mostyn–Dublin service in 2001. P&O has recently increased capacity on the northern corridor by introducing new larger vessels on its Cairnryan–Larne route. See Appendix B for more details.
- 5.9 Capacity utilization²⁴ is generally higher for the long-sea crossings than for the short-sea crossings. We have been told, however, that with the exception of some of the very frequent services (for example, Loch Ryan–Northern Ireland), peak night-time services, particularly travelling from Great Britain to Ireland, tend to be fully booked or even overbooked. Several hauliers told us that occasionally freight units (generally unaccompanied) were left on the quayside. Stena told us, on the other hand, that since the introduction of the *Adventurer*, there has almost always been spare capacity on its sailings between Holyhead and Dublin, including at peak. Appendix F gives more details of capacity and utilization, particularly on the central corridor.

Market concentration

- 5.10 The competitive structure in each of the relevant markets is set out in paragraphs 5.11 to 5.13.

²³Irish Ferries replaced the *Isle of Innisfree* in 1997 with the *Isle of Inishmore* and doubled its capacity in 2001 with the introduction of the *Ulysses*. Stena introduced the *Stena Forwarder* in 2001, increasing capacity by 40 per cent, and then introduced the *Stena Adventurer* in July 2003, increasing freight capacity by a further 70 per cent.

²⁴Across peak/off-peak and combining east/west and west/east flows.

- *Northern corridor*

5.11 There are currently three significant ferry operators on the northern corridor: P&O with a 48 per cent market share,²⁵ Norse Merchant Ferries with 24 per cent and Stena with 17 per cent. The remaining ferry operators are Seatruck and Coastal. In 2002 the total freight volume on P&O's Fleetwood–Larne route made up around 20 per cent of the market on the northern corridor. On P&O's Fleetwood–Larne route around two-thirds of the volume was unaccompanied. The most direct competition to P&O's Fleetwood–Larne route comes from Norse Merchant Ferries with its diagonal routes from Liverpool and Heysham to Belfast. Competition is also provided by the short-sea northern routes operated by P&O and Stena. Seatruck's service from Heysham to Warrenpoint also offers some competition, although this is a relatively small-scale operation that we were told is running more or less at full capacity. The effects of the merger in the northern corridor are discussed in paragraphs 5.34 and 5.35.

- *Central corridor*

5.12 On the central corridor, the position is rather different. P&O currently has the largest share of the central corridor at 33 per cent, with Norse Merchant Ferries at 25 per cent, Irish Ferries at 20 per cent and Stena at 17 per cent (2002 market shares). In 2002 the freight transported on P&O's Liverpool–Dublin route made up around 20 per cent of central corridor traffic. Around one-quarter (by volume) of the freight on P&O's Liverpool–Dublin route was accompanied in 2002; this increased to around [] in 2003. Again the most direct competition to P&O's Liverpool–Dublin route is from Norse Merchant Ferries, which provides a similar service on the same route out of the river berths at Birkenhead. There is also competition from all other routes into Dublin, including in particular Mostyn–Dublin and Holyhead–Dublin, as well as Norse Merchant Ferries' operation from Heysham to Dublin and, at the margins, Coastal's lo/lo service from Liverpool to Dublin. These market share figures would change somewhat with the closure of Mostyn–Dublin (see Appendix F).²⁶

5.13 The overlap in the central corridor between Stena and P&O currently is primarily in the area of accompanied freight, since Stena's current share of unaccompanied freight is very small. However, given the market definition outlined in paragraph 4.28, and the potential flexibility between accompanied and unaccompanied services, the distinction between accompanied and unaccompanied freight does not have a significant bearing on the assessment of the competitive effects of the proposed merger. Further details on market shares by route and by type of freight can be found in Appendix F. The effects of the merger on the central corridor are discussed in paragraphs 5.36 to 5.51. First, it is important to understand how pricing works in this market, as well as the relevant counterfactual.

Pricing

5.14 Pricing in the freight ferry market is opaque. The parties told us that there were no published tariff rates, although there was a 'cash' or 'spot' price at the port for a customer looking to ship a single load. Pricing is based on bilateral negotiations

²⁵Market share should be taken to be in terms of volume throughout unless otherwise stated. The figures are based on the parties' estimates for 2002 (see Appendix F).

²⁶In calculating market shares on the central corridor we have assumed that the traffic on the Mostyn–Dublin route is shared as follows: accompanied traffic shared between Stena's and Irish Ferries' Holyhead–Dublin routes; unaccompanied traffic shared between P&O's and Norse Merchant Ferries' Liverpool–Dublin routes.

between individual customers and the ferry company concerned. There are no formal contracts in place, but rather agreed terms on specific routes, based generally on the previous year's prices, expectations of volumes for the coming year, and any other features specific to that particular customer (see Appendix G). Prices may in part reflect the importance of that customer to the company as a whole, including business on other Irish Sea routes or outside the Irish Sea.

- 5.15 Prices are generally negotiated annually. Customers then book themselves on to ferries as required on a day-to-day basis. The evidence that we received from the parties, customers, and our surveys, showed that many customers, particularly the larger ones, will have accounts in place with a number of ferry companies. Although several parties told us that brand loyalty as such was low, customers told us that many of them had a preferred supplier of ferry services, with whom they carried out the majority of their business where feasible and practical. This was due to the importance of establishing a strong relationship with a ferry operator in order to benefit from good customer service, reliability, competitive prices (which will tend to improve with a greater volume shipped), and close working relationships with individual members of staff (see section 2.2 of AIA Survey report). This was less feasible for some of the very large customers due to lack of available capacity at peak times.
- 5.16 There are very few explicit volume-related discounts, but we have been told by several third parties that the initial negotiation of price reflects volume expectations, not just on a particular route, but also, to some extent, between customer and supplier as a whole. However, there are many factors influencing price, and volume is only one factor. We understand that the prices actually paid by an individual customer on a particular crossing also reflect the negotiating strength of the customer (heavily influenced by the volume of freight shipped), the length of the vehicle, and the time of the sailing (peak vs off-peak). As noted in Appendix G, we considered a variety of other evidence on prices paid by individual customers. This showed a high degree of variation in prices paid by individual customers, although there was a tendency for larger customers to pay lower prices (see Appendix G, Figures 3 to 6). For example, the mean deviation from the average (allowing for the effect of volume) was substantial, at around [] per cent on Stena's Holyhead–Dublin route and around [] per cent on P&O's Liverpool–Dublin route.
- 5.17 Paragraph 4.14 discussed the difference in prices between accompanied and unaccompanied loads. Stena's [] prices for accompanied freight are [] per cent above its prices for unaccompanied freight. P&O's average price differential between accompanied and unaccompanied freight on its Liverpool–Dublin route is much greater [] regardless of time of day; however, it was lower on its Scottish routes. Individual customer price differentials for both Stena and P&O also show considerable variation. See Appendix G for more details.
- 5.18 Different prices are also charged according to time of crossing, with night-time (peak) crossings being more expensive. The price differential between peak and off-peak is variable, but off-peak crossings will generally be significantly [] cheaper. We note that peak capacity is not rationed only by price. The parties have told us that some customers are allocated spaces on peak crossings and this allocation may be subject to 'off-peak support'²⁷ on some routes. Rather than ferry operators offering customers a set of prices and customers

²⁷ie an understanding that a certain amount of freight will be carried off-peak.

deciding how much to purchase on the basis of those prices, negotiations between ferry operators implicitly or explicitly cover both price and volume, peak and off-peak.

- 5.19 The opaque nature of this market means that ferry operators currently have the potential to price discriminate between customers. The data shows large variations in the prices paid by individual customers, even when adjusted for volume of business (see paragraph 5.16). We understand that these differences reflect a number of factors, including relative bargaining power. A customer's bargaining power will depend, among other factors, on the alternatives available, and we therefore believe it to be possible in principle for ferry operators to charge more for less-flexible customers with few viable alternative routes ('vulnerable' customers). Further, the close operating relationships between ferry operators and their customers referred to in paragraph 5.15, combined with the fact that the annual negotiation rounds are likely to yield useful information on customers' needs, leads us to think that some degree of price discrimination is likely to occur in practice.
- 5.20 The parties have argued that major customers, who account for a significant proportion of a ferry operator's total volume (particularly for unaccompanied operations), hold very substantial bargaining power. They say that experience shows that large customers, both unaccompanied and accompanied, will move substantial volumes between ferry operators in response to changes in competitive conditions, primarily price discounting. Smaller customers, whilst not themselves enjoying the same level of bargaining power, may by choice use either third party agents or larger hauliers to buy on their behalf and thus benefit from lower prices than they would otherwise be able to achieve. The parties argued that, in some cases, the threat of switching was sufficient for customers to achieve lower prices.
- 5.21 We agree that customers have different amounts of bargaining power and that larger customers have more bargaining power and will often get lower prices than smaller customers. However, given, in particular, the relationships customers build up with ferry operators (see paragraph 5.15), it is not necessarily easy or less costly for them to switch between ferry operators or to promote entry if prices rise. Clearly, the ability of a customer to make a credible threat depends on whether the customer has, or is perceived by the ferry operator to have, an effective and realistic choice of routes so that it can switch business between routes as threatened. Moreover, the spend of even the largest customers on Irish Sea ferry services is much less than the Irish Sea turnover of ferry companies such as Stena and P&O. Hence we do not accept the argument that most customers have sufficient countervailing power to prevent the exercise of market power by ferry companies. We consider in paragraph 5.39 the effects of the merger on different groups of customers.
- 5.22 The pricing mechanism described in paragraphs 5.14 to 5.19, and the need to develop good operating relationships with ferry companies to secure peak bookings on highly utilized services, as well as good service generally, means in practice that once pricing frameworks have been agreed, price does not play a major role in day-to-day decisions about which ferry operator or route a customer uses. For many of the respondents to the AIA survey, other factors including availability of places on peak sailings and reliability mattered more than price. The customers also told us that in many cases their freight journeys were relatively predictable and settled, at least in the short term, both because of the need to set up ongoing logistics (back loads, depot location etc) and to enable them to benefit from good levels of service as set out in paragraph 5.15. This appeared to be consistent with the relatively low

level of switching in response to potential price rises identified in the ORC survey. The survey showed that, of regular users of Stena or P&O services on the Fleetwood–Larne, Liverpool–Dublin and Holyhead–Dublin routes, only around one-third would definitely choose to switch for a hypothetical price increase of 5 per cent (see paragraph 4.23). We concluded that although customers were very concerned about their costs, the demand for ferry services on a particular crossing was relatively price inelastic, at least in the short to medium term.

- 5.23 In addition to some specific examples of customer switching, P&O provided us with evidence in the form of a list of examples of threatened and actual switching that it said suggested that customer switching was very easy and an ‘endemic’ feature of the market. The majority of the examples provided were threats of switching rather than actual switching. We saw this as evidence of an iterative and vigorous bargaining process for at least these customers, often resulting in price concessions rather than actual movements of business. Most customers have an incentive to play the ferry companies off against one another, although many do not have the power to do so successfully (see paragraphs 5.19 and 5.22). Some switching of business at the margin will, no doubt, always occur as part of this process, even for customers who are content with the service that they get. We concluded that although some examples of threatened switching in the Irish Sea had been provided, switching was not an endemic feature of the market. Furthermore, we do not believe that these examples provide sufficient evidence to refute the argument outlined in paragraph 5.21, namely that, on the whole, most customers do not have sufficient countervailing buyer power to prevent the exercise of market power by ferry companies.

Counterfactual

- 5.24 Before we turn to the effects of the proposed merger, we need to assess what would be likely to happen in the absence of the merger (the counterfactual). The counterfactual provides a benchmark against which the expected effects of the proposed merger can be assessed. We have focused on those factors we consider to be most important for the purposes of identifying a counterfactual for each relevant market.

Northern corridor

- 5.25 We considered whether or not we would expect to see a new entrant on the diagonal routes in the absence of the merger. Stena told us that for some time it had wanted to enter or acquire a diagonal route, both in order to offer greater choice to its customers, and also to provide an alternative to the short-sea northern routes since the forthcoming tighter regulation of drivers’ hours may, in the future, deter more customers travelling from England from choosing the long drive to Loch Ryan. P&O suggested that Stena would have had plenty of opportunity to enter this route over the past few years, and put forward its view that Irish Ferries would be a more likely entrant. We conclude the appropriate counterfactual in the northern corridor to be that Stena would be one of several potential entrants on the diagonal routes. We also note that P&O could not be considered to be a potential entrant on this route post-merger (quite apart from P&O’s desire to withdraw from this service, the conditional agreements include a non-compete clause).

Central corridor

- 5.26 The key factor associated with the likely counterfactual in relation to the central corridor is the future of the Mostyn–Dublin route. P&O told us that prior to opening the Mostyn–Dublin route it had planned to move to new river berths at Liverpool, to improve the service on its Liverpool–Dublin route particularly for accompanied traffic. For a variety of reasons, however, P&O decided to develop a ro/ro terminal at Mostyn. The Mostyn–Dublin route opened in November 2001. Two vessels operate on this route: the *Ambassador*, a new Ropax vessel, and the *Envoy*.
- 5.27 P&O told us that there were problems with the new route from the outset. In order to use Mostyn as a ro/ro terminal, dredging was required in an environmentally sensitive area of the Dee estuary. Although the initial capital dredging consents were obtained without difficulty, there were, and are, ongoing issues associated with obtaining long-term consents for adequate maintenance dredging. This has resulted in a service which is unable to operate in some tidal conditions and is therefore relatively unreliable in relation to timing. Variable timetables are published at the start of each month. In addition, in the first half of 2002 there were issues associated with the ramp at the Dublin terminal. P&O's management accounts showed that the route made a loss in 2002 of around £[redacted] million. Although lower freight rates have been introduced in an attempt to compensate for the unreliability of the service, this, combined with the lower-than-anticipated traffic volumes, has led to the economics of keeping the route open being questionable.
- 5.28 Initially we had some reservations about whether or not P&O would close the Mostyn–Dublin route in the absence of the proposed merger. We noted that the intended closure of the route was announced in conjunction with the proposed merger, and that payments in the MoU were expressed as contributions by Stena to the cost of closing Mostyn. We also considered a number of factors that could have led to P&O keeping the route open in the absence of the merger, namely whether:
- (a) it would be more profitable to continue to operate the route in its current form than it would be to close it absent the merger;
 - (b) P&O might change the vessels currently used on the route and relaunch the service as a lower-cost service focused on unaccompanied freight;
 - (c) the current dredging problems were likely to be resolved; and
 - (d) disclosure or accounting presentation considerations might influence the timing of the closure of the route.
- 5.29 The parties themselves, as well as many third parties, told us consistently that P&O was likely to close the Mostyn–Dublin route, regardless of whether or not the proposed merger went ahead. The main parties' arguments in support of the closure of the Mostyn–Dublin route are discussed in further detail in Appendix E.
- 5.30 If the Mostyn–Dublin route closed, the traffic that currently used this route would have to find alternatives. It is likely that the vessels on the Holyhead–Dublin route have sufficient spare capacity, even at peak times, to absorb the additional Mostyn traffic that would choose to re-route via Holyhead. We received evidence to suggest that there was a shortage of capacity at Liverpool, however, particularly at

peak times, travelling in the westbound direction, and on P&O's Liverpool–Dublin route (see Appendix F).²⁸ P&O told us in its initial submission that, in the absence of the merger, it had formed a preliminary view (although such a view had not been developed in full detail), that it might add a third, freight-only charter ship to its Liverpool–Dublin route, in order to be able to accommodate more of the ex-Mostyn–Dublin traffic. We believe this to be a likely scenario, particularly since, in the absence of an additional vessel, Norse Merchant Ferries would be likely to benefit more than P&O from the displaced Mostyn–Dublin traffic as there was significantly more spare capacity on both Norse Merchant Ferries routes (Liverpool–Dublin and Heysham–Dublin) than there was on the P&O service. We have also taken into account the fact that, prior to the opening of Mostyn, P&O operated at least three vessels on this route. In the period 1999–2001, even with the arrival of Norse Merchant Ferries on this route, P&O's total capacity on the route was greater than that of the two current vessels despite substantial growth in demand over the period. By adding a third vessel, P&O would preserve as far as possible the goodwill on the assets it employed on its Liverpool–Dublin route. Later P&O emphasized to us that the decision to add a third vessel would have to be taken at the time depending on the current circumstances. We discuss the post-merger capacity situation further in paragraph 5.38.

- 5.31 We note that the return on P&O's Liverpool–Dublin route is likely to increase should the Mostyn–Dublin route close (see Appendix I and paragraph 5.32). P&O told us that it would not wish to close its Liverpool–Dublin route in the absence of the merger and we believe that it would be in P&O's interest to maintain the value of this route. We also considered the likely ownership of the route. However, whether the route continues to be operated by P&O, or is sold to an alternative purchaser, we expect that any future owner will maintain service quality and customer goodwill on the route. We return to this again in the discussion of relevant customer benefits in section 6.
- 5.32 We concluded that there were two key factors in identifying the appropriate counterfactual for the central corridor. On balance, and taking account of the discussion in paragraphs 5.26 to 5.29 and Appendix E, we decided that P&O's Mostyn–Dublin route would close. We decided that the Liverpool–Dublin route currently operated by P&O would continue to operate at similar levels of service in the absence of the merger, with either P&O, or an alternative purchaser, as owner.

Effects of the merger

- 5.33 The effects of the merger are discussed in relation to each of the relevant markets in turn.

Northern corridor

- 5.34 As a result of the transfer of P&O's Fleetwood–Larne route to Stena, Stena's 17 per cent market share in the northern corridor (see paragraph 5.11) would rise to 36 per cent, and P&O's share would fall from 48 to 29 per cent. Three significant ferry operators would remain on the northern corridor, but Stena would replace P&O as the largest ferry operator, with short- and long-sea crossings on the northern corridor much as P&O has currently. Thus the merger does not create a market

²⁸In fact, P&O's Liverpool–Dublin route in 2003 has been running at [] throughout the week. Norse Merchant Ferries told us that its Liverpool–Dublin service had [] on most weekday peak sailings. Its overall capacity utilization was currently at around [] per cent.

leader but rather changes the identity of the leader. Indeed, the merger reduces concentration in this market, at least in the short term (see Appendix F).

- 5.35 Whilst the appropriate counterfactual, as set out in paragraph 5.25, was that Stena was one of several potential entrants on the diagonal routes, we did not receive evidence to suggest that Stena's threat of entry has had much impact on the competitiveness of the market. Further, we were unable to form an expectation that Stena would have entered a diagonal route with a new service in the next two to three years, not least because of its clearly stated preference for entry by acquisition. Finally, we found no evidence to form an expectation that the merger would reduce capacity on this route. We conclude, therefore, that the transfer of the Fleetwood–Larne route from P&O to Stena could not be expected to result in an SLC.

Central corridor

- 5.36 The pre-merger situation was set out in paragraph 5.12. Post merger, the four main competitors on the central corridor would reduce to three, as P&O would exit the central corridor, and Stena's market share would rise to 44 per cent. Market concentration on the central corridor would be significantly increased, and the merger would give Stena a market share significantly larger than its nearest rival (Norse Merchant Ferries would have a market share of 29 per cent and Irish Ferries 22 per cent). In addition, unlike its rivals, it would have a route on both the short and long central corridor crossings. We note, too, that, as stated in paragraph 5.7, both Irish Ferries, and, in particular, Norse Merchant Ferries, have some constraints in terms of their ability to compete. Whilst the change in market shares would be less significant with regard to unaccompanied freight, since Stena was only a very small unaccompanied central corridor operator pre-merger, Stena would have an even stronger position with regard to accompanied freight operations post-merger. The proposed merger would result in a large increase in concentration both in the market as a whole and in the accompanied segment (see Appendix F).
- 5.37 In paragraphs 5.38 to 5.43 we consider how Stena might exercise the market power that it would achieve as a result of becoming the market leader on the central corridor, in relation to, for example, decisions on capacity availability, on pricing (targeting price increases at customers who have fewest alternatives), and exploiting the 'one-stop shop' that Stena would now be able to offer (see paragraph 5.43). We then discuss how the remaining competitors on the central corridor might react to both capacity and pricing strategies in paragraphs 5.45 and 5.46.
- 5.38 In terms of capacity, we note that for a ferry operator each vessel incurs very high fixed capital-related and operating costs compared to variable customer-specific costs. Ferry companies therefore have an incentive to maximize the utilization of each vessel as far as possible. The relative capacity on the Liverpool–Dublin route post-merger compared with the counterfactual depends on a number of factors. Stena told us that it had no clear plans to add capacity to the route post-merger, although it did not rule out such a move.²⁹ P&O, on the other hand, initially indicated that it might add a third, freight-only vessel to its existing two vessels on its Liverpool–Dublin route following the closure of the Mostyn–Dublin route if the merger did not go ahead (provided the additional revenue from the traffic attracted

²⁹Stena also suggested that it might be able to generate modest amounts of new capacity without the need to invest in a third ship on the route [


to Liverpool exceeded the costs of the additional ship; see paragraph 5.30). P&O and Stena have different incentives in terms of capacity on the Liverpool–Dublin route. In the absence of the merger P&O, or an alternative purchaser of the Liverpool–Dublin route, would have an incentive to add a third ship to capture as much of the displaced Mostyn traffic as it could, and to avoid displacing existing traffic to its competitors (at Liverpool or Holyhead). On the other hand, post-merger, Stena’s incentive to add a third ship would be lower as it would be able to capture some of the Mostyn traffic, or displaced traffic from Liverpool, by filling the considerable spare capacity on the *Adventurer* at little additional cost. We therefore expect the merger to result in a reduction in capacity compared with the counterfactual. We assess the likely competitor incentives to increase capacity in paragraphs 5.45 and 5.46.

5.39 We concluded that, whether or not there was a reduction in capacity post-merger, with peak crossings from Liverpool already largely full, there would be scope for Stena post-merger to exercise market power by an increase in prices, particularly at peak times, at Liverpool, together with the opportunity to increase capacity utilization at Holyhead with less pressure to reduce prices than there might have been absent the merger. Although customers might choose to move to the relevant head-to-head competitor (Norse Merchant Ferries at Liverpool or Irish Ferries at Holyhead) in response to such an action from Stena, our surveys and some third party evidence suggested that this would not always be their preferred action. First, both competitor services have limited availability on a number of peak crossings; and second, some customers do not believe that Norse Merchant Ferries or Irish Ferries offer the same level of service (see paragraph 5.7). We therefore expect any action of Stena’s in relation to higher prices to affect directly the following categories of Stena and P&O customers:

- (a) those customers who were regular users of P&O’s Liverpool–Dublin service who regarded one of Stena’s routes as their closest alternative. The merger would weaken the negotiating position of such customers since they would no longer be able to threaten to switch volume to Stena;
- (b) those customers who were regular users of Stena’s Holyhead–Dublin service who regarded P&O’s Liverpool–Dublin route as their closest alternative;
- (c) those existing users of P&O’s Mostyn–Dublin route who preferred to re-route via P&O’s Liverpool–Dublin service but whose next best choice was Stena’s Holyhead–Dublin route;
- (d) those existing users of P&O’s Mostyn–Dublin service who preferred to re-route via Stena’s Holyhead–Dublin service but whose next best choice was P&O’s Liverpool–Dublin route; and
- (e) those existing users of P&O’s Mostyn–Dublin or Liverpool–Dublin services for whom, post-merger, the constraints on capacity on Stena’s Liverpool–Dublin service would force them to take an alternative, less favourable, crossing.

Many of these effects would be most applicable to accompanied freight, which in total constituted 46 per cent of the central corridor in 2002. We expect, however, that the anticipated price rises in the accompanied segment would have at least some effect on the prices for unaccompanied services since any changes in capacity would impact both the accompanied and unaccompanied segments of the market, and price negotiations take place at a customer level, covering both

segments. In addition, third party evidence that we received, as well as our surveys, identified a number of unaccompanied hauliers that expected to be affected by the merger. We therefore concluded that both accompanied and unaccompanied freight services would be affected by the merger.

- 5.40 We expect Stena to increase prices to the vulnerable customers identified in paragraph 5.39 and so increase its profits. Our view is that due to a lack of pricing transparency, and knowledge gained over time of individual customer preferences through close working relationships and the regular bargaining process, Stena has the ability to identify vulnerable customers and to price discriminate (see paragraph 5.19). Indeed we have seen that customers today pay widely differing prices (see paragraph 5.16 and Appendix G, Figures 3 to 6). Further, in the bilateral negotiation of prices, price discrimination may effectively be achieved by vulnerable customers showing less resistance to price increases than those with greater choice. This would not necessarily require a detailed understanding of customers' freight characteristics, nor would it necessarily result in a substantial increase in price in a single year, but rather would result over time in significant price increases to vulnerable customers. We consider that Stena would be able to focus price increases on vulnerable customers and may also be able to increase prices to other customers, albeit to a lesser extent.
- 5.41 In practice, we would expect such price increases to be focused on the Liverpool–Dublin route for the following reasons:
- (a) The ORC survey suggested that more P&O Liverpool–Dublin customers viewed Stena's Holyhead–Dublin route as the closest alternative than vice versa. Thus it would be more difficult for customers to resist a price increase on the Liverpool–Dublin route when the relatively close alternative of Stena's Holyhead–Dublin route was operated by the same company.
 - (b) Prices on Stena's Holyhead–Dublin crossing already appear relatively high (see Appendix G). Average price levels on Stena's Holyhead–Dublin crossing are [] P&O's Liverpool–Dublin crossing, despite the latter being approximately twice as far.
 - (c) We think it more likely than not that the merger would result in a reduction in capacity on the Liverpool–Dublin route compared with the counterfactual (see paragraph 5.38).
- 5.42 Post merger, on the Liverpool–Dublin route currently operated by P&O, we therefore expect to see higher prices and lower capacity than in the counterfactual, although, as noted in paragraph 5.39, even if capacity were not reduced we would still expect to see higher prices. On Stena's Holyhead–Dublin route, we expect those customers who regard P&O's Liverpool–Dublin route as their closest alternative to be charged higher prices than would have been the case in the absence of the merger (see paragraph 5.39(b)). We expect also that, as a result of the merger, Stena's Holyhead–Dublin route will gain more of the displaced Mostyn (or Liverpool–Dublin) traffic than it would otherwise have done (see paragraph 5.38), and consequently there might be less of an incentive for Stena to reduce prices at Holyhead in an attempt to attract additional traffic to fill some of its spare capacity.
- 5.43 One further way in which Stena could exercise market power relates to its ability to offer customers a choice between the Liverpool–Dublin and Holyhead–Dublin

routes, or a one-stop shop for both services. Given the evidence in the AIA survey and at hearings with customers about the importance of building up good operational relationships with ferry companies, we believe that this would offer Stena a strategic advantage over the single-route ferry operators and potentially the opportunity to 'lock in' more customers. This, in turn, is likely to give it a very strong market position well into the future, and will weaken both the ability and the incentive of rivals to acquire market share from Stena through price competition.

- 5.44 The majority of customers from whom we received evidence expressed concerns about the merger, covering price, quality of service and availability of capacity (see third party evidence on the CC web site). Respondents to the AIA survey also expressed a degree of concern and hostility towards the proposed merger: this was greater among companies using central corridor routes, those which predominantly used P&O rather than Stena, and among smaller haulage companies. We received mixed views about the merger from the ORC survey (see Appendix H, paragraph 39). Overall a material proportion of customers expected to suffer adverse effects as a result of the proposed merger.
- 5.45 We also considered how the two main competitors might respond to any exercise of market power by Stena. Given Norse Merchant Ferries' financial position in general, and [] (see Appendix J), we believed that it would probably welcome any increase in Stena's prices, since it would give it the opportunity to increase its own prices and hence profitability.³⁰ We have found no evidence to suggest that it would put any such benefit at risk by introducing new capacity with uncertain levels of utilization—[]].
- 5.46 We believe that Irish Ferries, like Stena, would benefit from any increase in prices on the Liverpool–Dublin route that displaced traffic to Holyhead, and that this would reduce its incentive to reduce price to fill capacity on its Holyhead–Dublin route. We have found no evidence to suggest that Irish Ferries would be likely to put on another vessel on the central corridor in addition to the *Ulysses*. Indeed, Irish Ferries told us that the utilization of the *Ulysses* was currently running at around [] per cent, although it was full on peak westbound crossings three nights a week. We therefore thought it unlikely that either Norse Merchant Ferries or Irish Ferries would seek to increase capacity on the central corridor to deter Stena from exercising market power in the way described in paragraphs 5.38 to 5.43, and we believed that the most likely independent reaction of the two main competitors would be to view any price increase by Stena as an opportunity to raise prices themselves, albeit possibly by a little less.
- 5.47 We discussed this possible lessening in competition on the central corridor with both Stena and P&O. The parties' views were that the key competitive pressure on each of the routes to be transferred was based on head-to-head competition. This, they argued, would not change as a result of the merger. The competition provided by the wider market was of much less significance, they said, particularly given the reluctance of customers to switch routes in response to a 5 to 10 per cent price rise. They also argued that there was no material difference in incentive between Stena

³⁰We note that when, earlier in the year, the administrators forced through a price increase, the only route that did not have a price increase was Liverpool–Dublin. This reinforces our view that Norse Merchant Ferries will be looking for a price increase in 2004 on the Liverpool–Dublin route.

post-merger and P&O in the absence of the merger to add more capacity to the Liverpool–Dublin route.

- 5.48 Stena has also argued that it would not be in a position to focus price rises on particular customers because of a lack of knowledge of individual customers' continually changing freight characteristics. Even if it were able successfully to identify such customers, Stena argued that it would not be profitable for it to increase prices post-merger in a discriminatory manner. The parties have carried out critical loss calculations which indicate that even small volume losses would be sufficient to render hypothetical price increases unprofitable, given the very substantial contribution made to fixed costs by each marginal customer. Thus, in the parties' view, successful price discrimination would require very detailed knowledge of customers' switching intentions, a knowledge which they tell us they simply do not have.
- 5.49 Whilst we agree that head-to-head competition is an important factor, we believe, given our market definition, that competition from all routes within the central corridor is important (see paragraphs 4.23 to 4.26). We have put forward arguments as to the difference in incentives between Stena and P&O, or an alternative purchaser, to add capacity to the Liverpool–Dublin route in paragraph 5.38. With regard to the parties' argument on price discrimination set out in paragraph 5.48, we believe that Stena would be in a position to price discriminate post-merger in a profitable way (see paragraph 5.40). The parties' critical loss calculations assume that there is a one-off opportunity to seek a 5 per cent price rise which, if successful, would result in increased revenue from that customer but, if unsuccessful, would result in the loss of all that customer's business on that route. In reality, however, the process by which bargains are struck is an iterative one. During the course of commercial discussions, customers' intentions are identified and bargains are struck accordingly. In addition, the likelihood would be that any such price rise would be achieved over a period of time, by small differences in the price increases achieved for different customers. The evidence that we have received from the parties on switching suggests that quite often the end result of the negotiation process is a revised price rather than a loss of business (see paragraph 5.23).
- 5.50 Given the opaque nature of pricing in this market, and the fact that prices are achieved through an iterative bargaining process, we conclude that Stena will be able to identify a set of vulnerable customers and, over time, achieve profitable price rises.
- 5.51 Finally, we considered our findings in the light of the parties' arguments that accompanied and unaccompanied freight are separate markets. We do not believe that the competitive effects outlined in paragraphs 5.38 to 5.43 are very sensitive to including both accompanied and unaccompanied in the same market as outlined in paragraph 4.28. We recognize that ferry operators and their customers in the two market segments may react differently to any potential price rise (see paragraph 4.17). We believe, however, that although the effects would be most applicable to the accompanied segment, there would be some effect on the unaccompanied segment (see paragraph 5.39).

Market entry

- 5.52 This section of the report focuses on the extent to which market entry into the central corridor might offset any possible SLC arising from the transfer of P&O's

Liverpool–Dublin route to Stena³¹. We also discuss briefly in paragraph 5.61 the opportunities for entry on the northern corridor.

5.53 We have reviewed the parties' account of the recent history of entry and expansion, and note that, in relation to ro/ro:

- (a) The level of entry over the past ten years has not been high, despite the high level of economic growth in Ireland in the 1990s.
- (b) The only entrant on the central corridor in the last ten years was Merchant Ferries (now part of Norse Merchant Ferries), which moved the destination of its Heysham service from Warrenpoint in Northern Ireland to Dublin in 1995 and started operating from Liverpool to Dublin in 1999. On the northern corridor the only entrant was Seatruck which started operating on the Heysham–Warrenpoint route in 1996 after Merchant Ferries ceased operating on this route.
- (c) There has been no entry on the short-sea central corridor routes (although Stena moved its conventional vessel service from Dun Laoghaire to Dublin in 1995), but these routes have seen a very large expansion of capacity by existing ferry operators (Stena and Irish Ferries).

5.54 In general, the key requirements for entry into a freight ferry service are:

- (a) access to suitable ports, with appropriate berths, sufficient surrounding land, and terminal buildings, available at peak times; and
- (b) access to a suitable vessel or vessels.

In addition, the entrant must have sufficient financial strength to be able to make a medium- to long-term investment and must also be able to attract a suitably-located customer base.

5.55 Focusing on the central corridor, we have been told by at least one third party that the Dublin berth currently available may be of limited value to unaccompanied ro/ro operations, at least in the short term, due to constraints on surrounding land. Another Dublin berth may become available in due course as a result of the Mostyn–Dublin closure. There are also possibilities for developing new ro/ro facilities at Greenore and Drogheda in Ireland. In Great Britain, there are two dock berths available at Liverpool, although access to these berths takes about 30 minutes longer than the river berths and there can be conflicts with other shipping needs. There is also the medium-term option of developing river berths near Langton dock, but this would require a significant commitment on the part of the ferry operator. There is an available berth at Holyhead and we expect one to become available at Mostyn as a result of the Mostyn–Dublin closure. As set out in paragraph 5.27 there are a number of issues associated with Mostyn as a ro/ro port. At Heysham and Fleetwood the only availability is off-peak. The development of a new berth would be likely to require a significant commitment on the part of the ferry operator. Overall, we have not found sufficient evidence to sustain an expectation that appropriate berths with sufficient surrounding land are available at

³¹We discussed the likelihood of Norse Merchant Ferries or Irish Ferries expanding capacity in the central corridor in paragraphs 5.45 and 5.46.

peak times on both sides of the Irish Sea in the short to medium term. Further details on berth availability are set out in Appendix C.

- 5.56 An entrant may obtain appropriate vessels by ordering a new vessel, or alternatively by purchasing second-hand or chartering a suitable vessel on the world market. Chartering is likely to be the least risky option for an entrant but not all types of vessel are readily available. We received evidence to suggest that ro/ro freighters were readily available, although identifying a suitable freighter and bringing it into service would nevertheless be likely to take a number of months. The evidence also suggested that finding a suitable ropax vessel for short-term charter (for example, on the long-sea crossings on the Irish Sea) might be more difficult: whilst some vessels were available, finding a ship that exactly suited the route might take longer.
- 5.57 Provided a potential entrant has access to a suitable vessel and berth at peak times, and has the appropriate level of financial backing, the other key requirement would be to attract sufficient customers quickly. An entrant would need to have or establish a reputation for reliability of service and to be seen as committed to the proposed new route in order to persuade significant numbers of customers to leave the incumbent ferry operator. This suggests that hit-and-run entry in response to high prices is unlikely to be successful. This is consistent with the evidence that we have been given that close working relationships between ferry companies and customers tend to 'lock in' customers.
- 5.58 Given the economies of scale required, and the need for a competitive freight operation to operate a daily timetable with peak and off-peak departures, we believe that entry on a small scale is unlikely to be viable. Even Seatruck, the smallest ro/ro operator on the Irish Sea, has a greater than 5 per cent market share on the northern corridor. Despite operating at very high levels of utilization, Seatruck's service provides only a modest competitive constraint on the larger ferry operators. Seatruck told us that [



]. If, however, large-scale entry were to occur, it would represent a significant increase in capacity, which we believe might result in a price war as the incumbents sought to retain as much of their business as possible. This prospect would, of course, raise the risk associated with entry as far as the entrant was concerned. In addition, we consider that incumbent ferry operators would be better able to target price reductions on those customers most likely to defect to a new entrant whilst entrants would initially have less ability to target due to their lack of market knowledge. Finally, we note, and one of the parties agreed, that incumbent ferry operators are likely to be able to increase their capacity on existing routes in response to an increase in demand more quickly than entrants can set up and start operating, and this represents a further deterrent to entry.

- 5.59 We heard from several third parties that it is common for entry to occur in response to the withdrawal of an existing ferry operator on a route and hence we considered the likelihood of entry when the Mostyn–Dublin service is withdrawn. Given the issues associated with using Mostyn as a ro/ro port set out in paragraph 5.27, we considered that, should a new service be attracted to the available berth at Mostyn, it would be likely to be a low-cost freighter operation, carrying predominantly non-time-sensitive or lo/lo freight, possibly offering services into Dublin if that berth were in fact to become free. However, we considered that this would be unlikely to pose

a serious threat to the existing major ferry operators on the central corridor for several reasons. Our view is that such an entrant would opt for a 'niche' entry strategy (such as that currently pursued by Seatruck and Coastal) that would not target either the accompanied market segment or the time-sensitive unaccompanied market segment. Further, given the strong working relationships between customers and leading ferry companies like Stena and P&O, as well as the added lock-in which we believe might occur were the merger to go ahead (see paragraph 5.43), we think that it is unlikely that such an entrant would be in a position to attract many customers of significance from Stena and P&O. Finally, [



] Although Stena mentioned a number of possible new entrants to us, who it thought might enter were the merger to occur and prices to rise, it was unable to explain why a potential entrant would be more willing to challenge the market leader that Stena would be after the merger, than to challenge P&O's more modest central corridor market leadership position were the merger not to occur.

- 5.60 We conclude that entry is not intrinsically difficult, and that potential entrants exist who might be prepared to come into the central corridor under appropriate market conditions. However, it would be particularly important for an entrant to have access to suitable berths and sufficient surrounding land available at peak times. Further, an entrant would need to attract and retain an economically viable customer base, which could be particularly difficult given the relatively settled behaviours observed in the market (see paragraph 5.22). We therefore conclude that entry or the threat of entry within the next two to three years will not offset the possible substantial lessening of competition in the central corridor.
- 5.61 Turning to the northern corridor, we believe that a number of factors point to entry here being more likely than in the central corridor, particularly in relation to the diagonal routes:
- (a) The diagonal routes in particular were seen by several parties as strategically important. We were told that, given a certain level of investment, these routes could be made much more attractive, potentially diverting traffic from the short-sea northern crossings. The forthcoming tighter regulation of drivers' hours might increase this likelihood (see paragraph 5.25).
 - (b) Of the four major players which currently operate on the Irish Sea and which might therefore be well placed to start new routes rapidly and on an effective scale, there is one, Irish Ferries, which is not present on the northern corridor.
 - (c) Although the increase in capacity in the central corridor has in part been driven by the forecast expansion of the Republic of Ireland's economy, we understand that, as actual growth has been below forecasts in the last few years, the increase in capacity has significantly outstripped demand on the central corridor. The northern corridor has not experienced the same level of capacity increase as the central corridor over recent years. The level of capacity utilization is currently somewhat higher on the northern corridor than on the central corridor. This is likely to remain the case even after the Mostyn–Dublin closure, and if no additional capacity is added by Stena to the Liverpool–Dublin route (see Appendix F, paragraph 8). There is therefore more scope for additional capacity to be installed on the northern corridor.

Conclusions on SLC test

5.62 We conclude that, as a result of the proposed merger, we do not expect there to be an SLC on the northern corridor, but we do expect there to be an SLC on the central corridor.

6. Relevant customer benefits and proposed remedies

6.1 This section of the report covers the proposed remedies that have been identified to address the SLC set out in paragraph 5.62. The questions on which the CC is required to decide, having found an SLC, are set out in section 36(2) of the Act. We must seek to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any resulting adverse effects.

6.2 We may also have regard to the effect of any remedy on relevant customer benefits. We describe our consideration of relevant customer benefits in paragraphs 6.3 to 6.7 before turning to consider possible remedies.

Relevant customer benefits

6.3 Relevant customer benefits are limited to lower prices, higher quality or greater choice of goods or services in any market in the UK, or greater innovation in relation to such goods or services. Such benefits are only defined as relevant customer benefits under the Act if we believe that they may be expected to accrue from the merger within a reasonable timescale and would be unlikely to accrue in the absence of the merger (or similar lessening of competition).

6.4 Stena has argued that it has brought significant innovation and investment to the Irish Sea in recent years, including:

(a) introduction of high-speed craft (HSS) capable of carrying freight as well as tourist traffic, together with innovatory docking systems and investment in the terminal at Dun Laoghaire;

(b) introduction of the *Stena Adventurer* on the Holyhead–Dublin route; and

(c) investment in a new berth and other facilities at Holyhead.

[



]

6.5

[



] Stena also argued that a beneficial effect of the merger was that it would substitute a company—Stena—whose core competence is in shipping and which is committed in the long term to investment and innovation, for a company—P&O—which is no longer committed to operating the ferry routes in question.

6.6 Stena argued that its record of commitment and investment leads it to be viewed as the strongest long-term player on the Irish Sea. It told us that the proposed merger would therefore lead to benefits for the freight community, whether or not these

could be defined as relevant customer benefits under the Act. For the reasons outlined in paragraph 6.7, however, we believe that similar benefits would be likely to accrue in the absence of the merger, and that these would not therefore constitute relevant customer benefits.

- 6.7 In relation to P&O's Liverpool–Dublin route, we have set out in paragraph 5.31 our view that, should the sale of the Liverpool–Dublin route to Stena not go ahead, P&O or any other future owner would maintain service quality and customer goodwill on the route. It is not clear that Stena would invest more than an alternative buyer, or P&O, to generate improvements in choice or quality of service. In addition, paragraph 5.38 set out our view that P&O, or an alternative purchaser, has a stronger incentive than Stena to add capacity to the route, although the parties argued that the investment decision would be the same. In conclusion, we do not expect relevant customer benefits as defined under the Act (see paragraph 6.3).

Proposed remedies

- 6.8 In our notice of possible remedies, published on 2 December 2003, we set out two possible remedies in relation to the central corridor:

- (a) a ban on the transfer from P&O to Stena of the vessels, berth slots and other associated assets which collectively constitute P&O's activities on the Liverpool–Dublin ferry route; or
- (b) action to facilitate access to berths by other existing or potential ferry operators in ports servicing the central corridor to the extent that barriers to entry are attributable to the property or contractual rights of the main parties, in order to reduce possible entry barriers due to restriction of access to suitable berths, with appropriate facilities, at peak times.

- 6.9 We have subsequently discussed both of these remedies with the parties, as well as soliciting views from third parties. We address each of the proposed remedies in turn, having regard to their effectiveness and associated cost (as set out in our guidelines).

Prohibition of transfer of P&O's Liverpool–Dublin route to Stena

- 6.10 Prohibiting the transfer of P&O's Liverpool–Dublin route to Stena would effectively prevent the expected SLC without the need for any action to be taken by others. It would involve ensuring that Stena did not acquire from P&O the vessels, rights to berths and slots, staff, and associated assets which collectively constitute P&O's activities on the Liverpool–Dublin ferry route.
- 6.11 We have discussed this option with both of the parties. Although the parties clearly did not see this as their preferred remedy, they told us that there would not be any particular issues associated with the design of such a remedy, since the assets had already been defined as part of the Central Transaction. They confirmed that there were no assets that were shared with the Fleetwood–Larne route that would need to be separated.
- 6.12 We concluded that prohibiting the transfer of P&O's Liverpool–Dublin route to Stena would be an effective remedy.

Facilitating entry on the central corridor

6.13 The second remedy that we put forward in our notice of possible remedies related to facilitating access to berths at Dublin port or more generally at ports on the central corridor. If one of the major obstacles to entry is access to berths, then ensuring that berths are freed up following the closure of the Mostyn–Dublin service might facilitate entry into the central corridor.

6.14 As we pursued this remedy, however, it became clear to us that it would be a necessary but perhaps not sufficient remedy to address the SLC. In part this is because berths are not the only potential obstacle to entry. Further, the creation of an opportunity for entry does not ensure that entry—or a credible threat of entry—will actually occur. From the evidence available to us, it seemed unlikely that any third party would consider entry (rather than acquisition) to be attractive on the Liverpool–Dublin route. [



] If, however, such entry were to occur, we expect the most likely type of entrant to be attracted to the central corridor to be a low-cost freighter operation focused on non-time-sensitive unaccompanied ro/ro or lo/lo freight (see paragraph 5.59), which was unlikely to be of sufficient scale and financial strength to provide a significant competitive constraint.

6.15 We concluded that the possible remedy set out in paragraph 6.8(b) would not in itself enable us to form an expectation of entry occurring in a reasonable timescale and on a sufficient scale to act as a competitive constraint to Stena and hence remedy the SLC identified. Of those third parties that expressed a view, most agreed.

6.16 In response to our notice of possible remedies, Stena proposed an enhanced package of behavioural remedies aimed at addressing the SLC more comprehensively. This involved the following undertakings:

- (a) to vacate a suitable berth and corresponding standage area at Dublin within three months of Stena commencing operation of P&O's Liverpool–Dublin route; and
- (b) to use no more Great Britain berths in the central corridor than Stena had been using on completion of the transaction.

In addition, Stena proposed undertakings either:

- (c) for an interim period (say 18 months) after the commencement of Stena's operation of a Liverpool–Dublin service, and in relation to this service:
 - (i) not to introduce additional capacity on the route;
 - (ii) to maintain the prices agreed between P&O and its existing customers on this route;
 - (iii) to cap rates offered to new customers on the route; and
 - (iv) to continue to operate a service on the route not materially different from that being offered by P&O at the date of announcement of the deal in May 2003;

- (d) to introduce additional capacity on the Liverpool–Dublin route at the end of this period (subject to commercial viability); or, as an alternative to (c) and (d)
- (e) to introduce additional capacity on the Liverpool–Dublin route as soon as practicable after P&O’s closure of its Mostyn–Dublin service (subject to commercial viability).

6.17 Stena argued that this package of remedies would provide an effective and practical solution to the competition concerns identified by the CC in its provisional findings. It said that the proposed undertaking in paragraph 6.16(a) would ensure that a spare berth and standage was made available in as short a timescale as practicable following completion of the merger. The undertaking in paragraph 6.16(b) was designed to demonstrate that Stena would not stifle or prevent entry on the central corridor through utilizing additional berths on the Great Britain side of the Irish Sea. Stena added that the undertakings set out in paragraph 6.16(c) would prevent the creation of any additional deterrent by Stena to potential entry or expansion on the long-sea central corridor, and would allay fears that Stena would raise prices to customers pending entry. As an alternative, Stena proposed a commitment to introducing additional capacity on the Liverpool–Dublin route as soon as practicable after P&O’s closure of its Mostyn–Dublin service (see paragraph 6.16(e)), intended to ensure that capacity on the long-sea central corridor will be no less than it would have been had the transaction not proceeded.

6.18 We discussed this proposed package of remedies with the parties, and solicited views from third parties. Our concerns were the following:

- (a) It was possible that the capacity freeze proposed by Stena would exacerbate the SLC if it prevented Stena from adding capacity when it might be commercially justified and no new entrant was forthcoming.
- (b) In terms of encouraging entry, it was also not clear whether the temporary nature of the freeze would give a potential entrant sufficient incentive to enter. We were told by third parties that an 18-month period would not be a sufficient window for a new operator to establish a service and attract enough customers to make the operation viable, particularly given Stena’s ability to respond strategically to target the new entrant’s potential customers, and its strong position in scheduling services for those using the UK as a landbridge to Continental Europe. However, although one third party thought that lengthening the period to three years might be sufficient, we believe that this would merely exacerbate the difficulties set out in paragraph 6.18(a).
- (c) We did not believe that a price cap was likely to be effective in a market of this nature. There is a lack of transparency in the market, as well as a lack of formal contracts between ferry operators and customers (see paragraph 5.14). In addition, since price is not the only relevant factor—availability on peak crossings, for example, may also be important (see paragraph 5.18)—a cap on price was unlikely to be effective in limiting Stena’s market power. Any remedy would by necessity be very intrusive, and enforcement and monitoring would be very difficult, making it less likely that such a remedy would be effective. Even if the price freeze could be made to work, there was a danger that such a freeze would discourage entry by limiting the likely revenue that a new entrant could achieve.

- (d) The alternative proposal of introducing capacity as soon as possible after the closure of the Mostyn–Dublin route would discourage entry by another operator and give Stena a further opportunity to exploit the market power we believe that it would have as a result of the merger. In addition, it would be very difficult to measure and monitor effectively the suggested caveat that the capacity would be introduced subject to commercial viability, particularly given the inevitable subjectivity of many of the assumptions made in the investment case.
- (e) The proposals about pricing, capacity and continuity of service involved a high degree of continuing regulatory interference which would run the risk of distorting the existing relationships between ferry operators and their customers.
- (f) Finally, given the complexity of the proposed package of remedies, setting up effective monitoring for a relatively short time period, possibly requiring independent verification of data supplied, would be impracticable.

6.19 Given the views set out in paragraph 6.18 and the views on entry in paragraph 6.14 and 6.15, we concluded that this package of remedies would not be effective in promoting entry that would act as a sufficient competitive constraint. It would not therefore remedy the effects of the SLC.

Conclusions on proposed remedies

6.20 We conclude that the action that should be taken for the purpose of remedying, mitigating or preventing the SLC is the prohibition of the transfer of the assets used on the Liverpool–Dublin route from P&O to Stena. Given that this would prevent the expected SLC, we do not recommend any action to be taken by others.