

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

A report on the proposed merger



MONOPOLIES AND MERGERS COMMISSION

The Peninsular and Oriental Steam Navigation Company and Stena Line AB

A report on the proposed merger

**Presented to Parliament by the Secretary of State for Trade
and Industry by Command of Her Majesty
November 1997**

Members of the Monopolies and Mergers Commission as at 4 April 1997

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¹These members formed the Group which was responsible for this report under the chairmanship of Mr D G Goyder.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which she considers would not be in the public interest to disclose and which, in her opinion, would seriously and prejudicially affect certain interests. The omissions are indicated by a note in the text.

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Part I

Summary and Conclusions

1 Summary

1.1. The Peninsular and Oriental Steam Navigation Company (P&O) and Stena Line AB (Stena) are two of the major cross-Channel ferry operators for both passengers and freight. Competition between them and with other ferry operators has been substantially affected by the opening of the Channel Tunnel in 1994.

1.2. P&O is a substantial public company with ten divisions. Its ferry division is operated as P&O Ferries which in 1995 contributed £73.5 million towards the profits of the P&O group. However, results for 1996 show a decline to a profit of £41 million out of total group profits of £509.3 million. The turnover of P&O Ferries in 1996 was £602.5 million out of a total group turnover of £7,090.8 million. Stena is a Swedish group controlled by the Sten Allan Olsson family which operates ferries in Scandinavian waters and the Irish Sea as well as in the English Channel and on the Harwich-Hook of Holland route. All services from the UK, except on the Harwich-Hook of Holland route, are operated by Stena's subsidiary Stena Line (UK) Limited. The ferry operations of Stena Line (UK) Limited made an operating profit of £24.1 million in 1995 but a loss of £[*] million in 1996. In 1996, its English Channel ferry operations comprised 39 per cent of Stena's total turnover amounting to £767 million.

1.3. On 28 November 1996 we were asked to investigate and report on a proposed joint venture between P&O and Stena. Our terms of reference are at Appendix 1.1. Under the terms of an agreement between them, P&O and Stena would transfer the businesses operating their ferry services on the Dover-Calais, Dover-Zeebrugge and Newhaven-Dieppe routes to a joint venture company. The service on the Dover-Zeebrugge route is for freight only; the other routes carry both passengers and freight. On-shore activities including sales and marketing, fleet management and administration would also be combined. In total the joint venture would take over assets worth £[*] million from P&O and £[*] million from Stena. It would initially operate 11 ferries: six multi-purpose vessels operating on the Dover-Calais route, three freight vessels for the Dover-Zeebrugge route and a multi-purpose ferry and fast craft operating on the Newhaven-Dieppe route. P&O would contribute eight of these vessels and Stena three.

1.4. We concluded that the markets relevant to this investigation were different for passengers and freight. In the case of passenger services the relevant market comprised routes we describe as the 'Short Sea routes' including services between Newhaven, Folkestone, Dover and Ramsgate in the UK and Dieppe, Boulogne, Calais, Dunkirk, Ostend and Zeebrugge in north-east France and Belgium. The Channel Tunnel also serves this market. Although they are longer than other routes in this sector the Newhaven-Dieppe and Ramsgate-Ostend routes are both to be served by fast craft which considerably reduce crossing time; so long as this is the case, both routes will provide sufficient competition for services on the other shorter routes to be regarded as part of the same market.

1.5. In the case of freight services, from which we exclude bulk freight services, the market is wider. The choice of route by the freight transport industry depends on a number of factors

*Figures omitted. See note on page iv.

including time and the need for drivers' rest periods. But the most important factor is the overall cost from origin to destination and road journeys may therefore be extended to take advantage of lower rates. There is strong evidence of competition between services on the Short Sea routes and those provided on longer routes. We conclude that the joint venture would operate in an Anglo-Continental freight market for unitized freight comprising routes on the Short Sea including the Tunnel itself, but also on the North Sea and Western Channel.

1.6. Both these markets comprise a number of separate routes but it is the Dover-Calais route which is the largest and most important. Immediately prior to the opening of the Tunnel it was also substantially the most profitable. In the case of the passenger market, however, a large percentage of income earned on this route, and indeed other routes, derives from retail sales, particularly of duty-free items. Ferry companies and the Tunnel's operator, Eurotunnel, have sought to maximize sales to passengers both of duty-free and of other goods. The expected abolition of the duty-free concession at the end of June 1999 is likely to bring a serious loss of income to all operators on these routes.

1.7. The opening of the Channel Tunnel has introduced substantial new capacity to the market for both freight and passengers. Ferry operators have themselves added to this excess capacity in their efforts to offer frequent sailings. Demand has grown strongly in both markets but falls far short of the capacity added. Against this background, fares and freight rates have fallen substantially since 1994 and the profits of all operators on the Short Sea routes have declined, with some making losses for the first time in recent years.

1.8. In 1996 the total value of cross-Channel passenger services on Short Sea routes to France was just below £500 million. P&O and Stena together carried 46 per cent of passenger vehicle traffic on these routes compared with 39 per cent carried by Le Shuttle. The remaining operators shared 15 per cent. In the slightly wider Short Sea market created by the commencement of a significant fast craft service to Ostend in March 1997 competition is currently provided to P&O and Stena by SeaFrance (previously operating a pooled service with Stena which terminated at the end of 1995), Holyman Sally Ltd (Holyman Sally) operating from Ramsgate, Hoverspeed UK Ltd (Hoverspeed) and rail services through the Tunnel (on Le Shuttle and Eurostar).

1.9. Within the Anglo-Continental freight market, in addition to services through the Tunnel (Le Shuttle-Freight and through-freight services) competition is provided by a considerable number of operators with multi-purpose or freight-only vessels including SeaFrance and Holyman Sally on the Short Sea routes. In 1996 the P&O and Stena ferry operations prospectively within the joint venture had a combined share of 24 per cent of all freight in the Anglo-Continental market; the Tunnel held 15 per cent and all other operators, including P&O and Stena on routes not served by the joint venture, held a total of 61 per cent.

1.10. In examining the structure of these markets we have focused on the position in the first ten months of 1996 because the normal pattern of traffic was interrupted by a serious fire in the Tunnel on 18 November 1996. All services, with the exception of Le Shuttle-Freight, have now been resumed at least on a limited basis. Le Shuttle-Freight's service remains suspended pending the outcome of safety inquiries.

1.11. P&O and Stena say that the joint venture is necessary in order to provide a continuous 'turn-up-and-go' service of a high quality which will offer an attractive alternative to Le Shuttle for both passenger and freight services. The six ships to be operated by the joint venture on the Dover-Calais route would be scheduled to leave at 45-minute intervals for 18 hours and at hourly intervals for the remainder of the day. But the service would require fewer ships than P&O and Stena currently operate on this route. They expect the total savings arising from the joint venture to amount in a full year to £75 million although reorganization

costs and the need to dispose of surplus vessels would result in a substantially smaller saving during the first year.

1.12. We believe that competition in the relevant passenger market would remain effective until duty-free concessions are abolished in mid-1999. We expect existing operators to remain in the market until then, particularly in view of the substantial investments they have recently made in their services. However, we expect conditions in the passenger market to become much tougher thereafter. We would expect the combined market power of the joint venture and Le Shuttle to be such as to lead in those circumstances to one or more of the other ferry operators leaving the market. We consider that new entry to the market at that stage and for some time afterwards would be costly, risky and unlikely on all but a seasonal basis. One or two niche operators might remain in the market but we expect the relative scale of marketing power of the joint venture and Le Shuttle to ensure that these other operators could not significantly expand their market share or compete effectively enough to prevent the emergence of an effective duopoly.

1.13. We therefore believe that this reduction of competition would create an effective duopoly between Le Shuttle and the joint venture. We take the view that, in general, such duopolies tend to settle down into a pattern of parallel behaviour, particularly on pricing policies. Had the operating costs of Le Shuttle been significantly lower than the joint venture then we believe that a pattern of parallel behaviour between them would be less likely, but this is not the case. Our analysis of the costs of Le Shuttle have led us to the conclusion that these are likely to be at best comparable to those of the ferry operators and may well indeed be higher, even without any element of interest or debt repayment by Eurotunnel. Moreover Le Shuttle has constraints on the use of its operating capacity which may well make a strategy of raising prices, rather than merely seeking additional market share, attractive at least at certain times of year. In these circumstances we expect that there would be some form of parallel pricing between Le Shuttle and the joint venture leading to a level of prices higher than is necessary to maintain a sustainable ferry alternative to the Tunnel.

1.14. We would not expect the same pattern to emerge if the joint venture did not proceed. We believe that P&O would remain in the market, and that the other competitors, including Stena, would remain as independent competitors at least until 1999. Thereafter we expect that, although one or more ferry operators may exit the market, at least one significant competitor would remain in competition with P&O and Le Shuttle.

1.15. By contrast, we believe that competition in the freight market for the joint venture and Le Shuttle will continue to be effective even after 1999. This market is largely unaffected by the loss of duty-free revenue and is characterized by the existence of a larger number of operators. We believe that Le Shuttle-Freight is likely to resume operation later this year; and there are a number of other competitors not connected with P&O, Stena or Eurotunnel who carry together some 39 per cent of all freight in the market. We take the view that present levels of freight rates reflect over-capacity which is unlikely to be sustainable. However, if either Eurotunnel or the joint venture raised freight rates significantly the freight transport industry on both sides of the Channel would have a number of alternative options.

1.16. We accept that the joint venture does offer some benefits in terms of cost savings, improved schedules and on-board facilities, improved prospects for Dover-Zeebrugge and Newhaven-Dieppe services and of the creation of a durable competitor to Eurotunnel. We believe, however, that the most important benefit, namely the potential cost savings, would not flow through to the benefit of the public unless the joint venture were operating in a competitive market with other ferry operators. We do not consider that this will be the case and we conclude that the likely service benefits of the joint venture do not outweigh the detriments to the public interest, in the form of higher prices, which it would bring about.

1.17. We have therefore concluded that the joint venture would operate against the public interest. We take the view, however, that adjustments of cross-Channel capacity are necessary as the result of the opening of the Tunnel and that the joint venture could bring other benefits to the public interest given a sufficiently competitive environment. The majority of us believe that conditions could be secured under which effective competition from ferry companies to the joint venture would be preserved. In those circumstances the joint venture should be allowed to proceed after the giving of appropriate undertakings.

1.18. The majority of the Group therefore recommend that P&O and Stena (and where appropriate the joint venture) should be required to give undertakings before completing or implementing the agreement to set up the joint venture that:

- (a)* the joint venture would not introduce services using fast craft on any Short Sea route (except on Newhaven-Dieppe where such a service already exists), though this restriction should be subject to a review by the Director General of Fair Trading (DGFT) after five years;
- (b)* the joint venture would introduce interlining arrangements for full fare tickets on the Dover-Calais route where requested to do so by other ferry operators;
- (c)* the joint venture would provide the DGFT with an appropriate range of financial and other information to enable monitoring of the nature of its competition with other ferry operators;
- (d)* P&O, Stena and the joint venture would not negotiate arrangements with travel agents jointly or aggregate incomes for the purpose of calculating commission;
- (e)* the joint venture would not enter into any exclusive arrangements with travel agents;
- (f)* P&O and Stena would not advertise the joint venture's services in promotional publications, brochures or advertisements which they had produced or commissioned; and
- (g)* P&O and Stena would give up any existing rights to one of the ticket desks at present operated by P&O and Stena at Dover and to not less than four vehicle ticketing booths at Dover.

1.19. One member of our Group, however, whilst agreeing with our conclusions on the public interest, did not believe that these or any other remedies would be appropriate or sufficient to ensure that effective competition is preserved and therefore believed that the merger should not be permitted.