

# 2 Conclusions

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## Introduction

2.1. On 17 September 1999 the Secretary of State referred to us the acquisition by CHC of HSG. Our terms of reference are given in Appendix 1.1.

## The companies and the merger

2.2. CHC is a Canadian company engaged in the provision of helicopter services in many parts of the world. In 1994 it acquired 100 per cent of the shares of Brintel, a UK helicopter services company one of whose main activities is the supply of helicopter services to oil and gas installations on the UKCS. For the year ended 30 April 1999 CHC's turnover was about £104 million and its operating profit some £15 million (see Table 3.2). In the same period Brintel's turnover was £[ ] million and its operating profit £[ ] million (see Table 3.9). About [ ] per cent of Brintel's revenue was derived from the UKCS. Brintel lost a large contract with Shell UK Limited (Shell) in 1998 and this had a major impact on its financial performance: its turnover in 1998/99 was about two-thirds of the value in 1997/98 and its operating profit less than half.

2.3. Helicopter companies serving the UKCS are required to be majority owned and substantially controlled by nationals of the member states of the EEA. CHC meets this require-

ment through its Chairman, Mr Craig Dobbin, who has dual Canadian and Irish citizenship and owns the majority of CHC's shares (see Table 3.1).

2.4. HSG is a Norwegian-registered company which provides helicopter services in many parts of the world. It acquired 100 per cent of the shares of Bond, a UK helicopter company, in a multi-stage acquisition arising from an agreement with the previous owners of Bond in 1994. In the year ended 31 December 1998 HSG had a revenue of about £214 million and an operating profit of some £15 million (see Table 3.14). In the same year Bond had a turnover £61.5 million and an operating profit £9.2 million (see Table 3.18). About [§] per cent of Bond's revenue was from UKCS activities.

2.5. In July 1999 Bond Air Services (BAS), the onshore helicopter division of Bond (ie the division providing helicopter services other than to the UKCS), was sold by HSG to a company owned by Stephen and Peter Bond.

2.6. CHC acquired HSG through its wholly-owned indirect subsidiary in Norway, Vinland Helicopters AS (Vinland), a company set up for that purpose. The acquisition began on 3 March 1999, when CHC contracted to buy 25 per cent of HSG's shares, and proceeded by a series of stages (see Appendix 3.1, paragraphs 1 to 22). By 1 October 1999 Vinland had secured 100 per cent of HSG's shares. CHC told us that the acquisition had been opportunistic and triggered by the low level of HSG's share price in early 1999. It said that its purpose in acquiring HSG was to achieve cost savings and other synergies and to produce a helicopter group with a broader and more robust business base which would be better able to meet the requirements of its customers.

2.7. The process of integrating CHC and HSG started in summer 1999. Prior to the reference to us Brintel and Bond, both of which are based at Aberdeen Airport, had been given a unified top management structure and a new name, Scotia Helicopters Services. At the time of the reference the Office of Fair Trading (OFT) sought and obtained undertakings from CHC not to proceed further with the integration of Brintel and Bond while our inquiry was taking place.

2.8. Further details about the companies and the acquisition are given in paragraphs 3.1 to 3.68.

2.9. In so far as it relates to the activities of UK companies, CHC's acquisition of HSG is similar to the proposed acquisition by Bond of British International Helicopters Ltd (BIH), Brintel's predecessor, in 1992 which was the subject of a report (the 1992 report) by the Monopolies and Mergers Commission (MMC), the predecessor of the Competition Commission.<sup>1</sup> The MMC concluded that Bond's acquisition of BIH might be expected to operate against the public interest. We refer to the findings of this report, and to changes in circumstances since 1992, at various places throughout this chapter.

## **Jurisdiction**

2.10. The first question we are required to answer is whether a merger situation qualifying for investigation has been created as a result of CHC's acquisition of HSG. There are three points we need to consider:

- (a) whether enterprises carried on by or under the control of CHC have ceased to be distinct from enterprises carried on by or under the control of HSG, of which one at least was carried on in the UK;

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<sup>1</sup>*Bond Helicopters Limited and British International Helicopters Ltd: a report on the merger situation*, HMSO, Cm 2060, September 1992.

- (b) whether these enterprises ceased to be distinct in the course of transactions which fall within section 66A(2) of the Fair Trading Act 1973 (the Act), and which in our opinion should be treated as having occurred simultaneously on the date on which CHC acquired a controlling interest in HSG, being a date which is less than four months from the date of the reference; and
- (c) whether as a result the condition specified in section 64(3) of the Act prevails, or does so to a greater extent, in the UK or a substantial part of the UK.

2.11. We are satisfied that the condition specified in (a) has been met. Although full integration of CHC and HSG has been suspended as a result of the undertakings given by CHC to the OFT, CHC has acquired a controlling interest in HSG and thus the enterprises carried on by both companies have already ceased to be distinct. It is also clear that one of the enterprises of HSG, Bond, is carried out in the UK.

2.12. We are also satisfied that the condition specified in (b) has been met. As described in Appendix 3.1, CHC acquired HSG in a series of transactions starting on 3 March 1999. The transactions taking place from 3 March to the date on which CHC acquired a controlling interest are transactions falling within section 66A(2).<sup>1</sup> We believe they should be treated, for the purposes of section 66A, as having occurred simultaneously on the date on which CHC acquired a controlling interest, and CHC did not argue that section 66A should not be applied.

2.13. CHC said that the date on which it acquired a controlling interest in HSG was not clear. Its considered view was that such interest was not acquired until 2 August, at the earliest, or alternatively 11 August. Section 66A(6) of the Act provides that in determining the time at which any transaction occurs, no account shall be taken of any option or other conditional right until the option is exercised or the condition is satisfied. CHC told us that its public voluntary offer, which was made on 26 April, and increased on 10 June, was conditional, but became unconditional on 2 August. As a result of that CHC had control of well over 50 per cent of the shares in HSG. It appears to us therefore that CHC acquired a controlling interest in HSG on 2 August, a date well within the period of four months before the date of the reference.

2.14. On (c) our terms of reference refer to the UK sector of the North Sea. The North Sea is an ill-defined area; in particular it is unclear whether it should include or exclude the area immediately to the west of Shetland in which there are oil installations. We think it would be better to use the UKCS north of latitude 56°N, for which there are well-established boundaries, as the relevant area for determining share of supply. The UKCS, which is the same as the UK sector of the North West European Continental Shelf (NWECS), is shown in Figure 4.1.

2.15. As can be seen from Table 4.6, Brintel has a 12 per cent share of the supply of helicopter services, measured by turnover, from places onshore in the UK to oil and gas installations north of latitude 56°N on the UKCS; Bond has a 26 per cent share. Hence the conditions specified in section 64(3) of the Act, namely that at least one-quarter of those services which are supplied in the UK are supplied by one and the same person, prevails to a greater extent as a result of the merger.

2.16. In view of the points set out in paragraphs 2.11 to 2.15 we conclude that a merger situation qualifying for investigation has been created by CHC's acquisition of HSG.

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<sup>1</sup>Section 66A(2) provides:

The transactions falling within this subsection are:

(a) any transaction which:

- (i) enables that person or group of persons directly or indirectly to control or materially to influence the policy of any person carrying on the enterprise;
- (ii) enables that person or group of persons to do so to a greater degree; or
- (iii) is a step (whether direct or indirect) towards enabling that person or group of persons to do so; and

(b) any transaction whereby that person or group of persons acquires a controlling interest in the enterprise or, where the enterprise is carried on by a body corporate, in that body corporate.

2.17. In the remainder of this chapter we consider the second question put to us, whether the merger situation created operates, or may be expected to operate, against the public interest. Both CHC and HSG carry on business in many parts of the world. We are concerned only about the impact of the merger on the UK public interest. So far as the UK is concerned, the two companies overlap in the provision of helicopter services to offshore oil and gas installations. We begin by defining the relevant markets for the purposes of assessing the effects of the merger on those markets.

## **Market definition**

2.18. The product referred to in our terms of reference is helicopter services to offshore oil and gas installations. We believe that these services constitute a distinct market for the following reasons:

- (a) There is no satisfactory substitute for them on the demand side. Helicopters mainly transport people to and from offshore installations. The alternative of a sea crossing is not usually feasible because of the danger of sea landing and unloading at these installations.
- (b) Supply-side substitution is limited by the fact that onshore helicopter operators do not own aircraft which have the necessary modifications and equipment for offshore work.

2.19. On the definition of the geographical market, our terms of reference refer to installations north of latitude 56°N in the UK sector of the North Sea. We have already given our reasons for preferring to use the UKCS rather than the North Sea. CHC put it to us that the Northern Zone (ie north of latitude 56°N) of the UKCS was a distinct market for a variety of reasons including the customer's preferred departure point, the distances and payloads involved which limit the types of helicopter that can be used, and the existence of national boundaries (for example, a UK helicopter operator requires special permission to supply an installation in the Norwegian sector). We agree that these factors greatly reduce the scope for substitution. Although it would be possible in principle for a helicopter operator based in another EEA member state to enter the UK market by setting up a small satellite base here, we think that this possibility is more conveniently considered under market entry rather than by widening the geographical definition of the market.

2.20. The provision of services to the Northern and Southern Zones (the latter being south of 56°N) of the UKCS are distinct markets because the onshore bases and type of aircraft required for each differ. At the time of the merger Brintel had no contracts in the Southern Zone and hence CHC's acquisition of HSG did not change the concentration of that market. However, competition between offshore helicopter operators chiefly consists in competition to win contracts from oil and gas companies. Although Brintel has been unsuccessful in winning contracts in the Southern Zone in recent years it has nevertheless competed for them. Thus the merger will reduce by one the number of helicopter operators competing for contracts there. Because of this we decided that we ought to look at the effects of the merger on services provided to both the Northern and the Southern Zones, treated as distinct markets.

2.21. Since 1992 three companies have served the Northern Zone market: Brintel, Bond and Bristow, a UK helicopter operator whose parent company is 49 per cent owned by OLOG, a US company which we were told was the largest provider of helicopter services in the world. In the Southern Zone the same three companies have competed for contracts since 1992 and were joined for a period by a UK subsidiary of KLM ERA Helicopters BV (KLM ERA). The latter was created in 1991 when the parent company of Era Aviation Inc (Era, a US helicopter company) acquired a 49 per cent share of KLM Helicopters BV, a subsidiary of the Dutch airline company. KLM ERA won a contract from Shell in 1995 which it lost in 1998; it was subsequently sold to Schreiner BV (Schreiner), another Dutch company, which we were told

had also recently bid for contracts in the Southern Zone. Market shares for the Northern and Southern Zones are given in Table 4.6. The total size of the Northern Zone market in 1998 was some £123 million; the Southern Zone market, with a value of about £28 million, was much smaller.

## **Main issues**

2.22. We assessed the public interest implications of the merger by considering the answers to four critical questions:

- (a) Would Brintel have remained in the market in the absence of the merger?
- (b) Are entry barriers sufficiently high that entry by another operator would be unlikely even if prices were to rise after the merger?
- (c) Would a duopoly materially reduce the level of competition in the supply of helicopter services?
- (d) Is the buyer power of the oil companies insufficient to prevent any reduction in competition leading to higher prices or other adverse effects?

2.23. We discuss each of these questions in turn in the following sections.

## **Demand trends and the capacity of the market**

2.24. CHC told us that demand for helicopter services to installations in the UKCS had declined since 1992, and it sent us copies of a report prepared in 1999 for Brintel by Smith Rea Energy Associates Limited (SREA) in support of its claim. Figure 4.2 shows the growth of the offshore helicopter market since 1970. Demand, measured by helicopter hours flown and passenger numbers, increased up to 1984/85 as the UK offshore oil and gas sector expanded. It fell in 1986 and 1987 but recovered to reach a peak in 1990. It then declined sharply from 1990 to 1993, after which it remained broadly static until 1998. Forecasts by the UK Offshore Operators Association Limited suggest that helicopter traffic in 2000 will be 18 per cent lower than in 1998, taking the Northern and Southern Zones together (see Table 4.5).

2.25. Figures for revenue, measured in terms of the prices of the day, show a broadly similar picture (see paragraph 4.37): there was a decline from £168 million in 1991 to an estimated £124 million in 1999, but the period 1994 to 1998 was broadly stable at around £150 million. Revenue measured at money of the day prices includes the effects of inflation. If the retail price index is applied to the revenue figures they show a decline of about 40 per cent between 1991 and 1999.

2.26. CHC ascribed the decline in the demand for helicopter services partly to a decline in the number of people working offshore arising from:

- (a) mature fields, with less exploration activity;
- (b) increased use of technology leading to unmanned installations; and
- (c) multi-skilling leading to reduced manning levels;

and partly to changes in the way that oil companies operated, namely:

- (d) a reduction in the frequency of shift changes by lengthening the average stay offshore; and

(e) the pooling of helicopter services by various oil companies and third party sharing of flights.

2.27. These factors vary in their importance. For example, unmanned installations are only found in the Southern Zone and will therefore have relatively little impact on overall demand. And BP Amoco plc (BP Amoco) told us that it had given up the use of longer shifts and had reverted to the older shift pattern. Conversely, pooling and flight sharing seems likely to increase in importance. A new industry organization, supported by the Department of Trade and Industry, called LOGIC (Leading Oil & Gas Industry Competitiveness) has recently been set up 'to facilitate collaborative initiatives in the industry' as a means of improving competitiveness. Pooling and flight sharing are obvious ways to reduce helicopter supply costs.

2.28. The SREA report found that expenditure by the oil and gas industry on the UKCS was forecast to decline over the next few years. Based on this finding CHC told us that it also expected demand for helicopter services to continue to decline and that the recent firming of the oil price did not change its expectation of declining demand.

2.29. The SREA report also said that helicopter operators had been moderately successful in reducing their stock of machines in line with the fall in demand. Nevertheless it noted that there were four helicopters in store in the UK and that a surplus was also reported by Schreiner in 1998.

2.30. We considered whether current and future levels of demand for helicopter services were such that it was unlikely that more than two operators could profitably remain in the market. Three companies appear to have operated successfully throughout most of the 1990s. BIH's troubles in 1991/92 arose primarily because it had been part of the Maxwell Group, which had gone into receivership leaving Brintel with substantial unpaid intra-group receivables, rather than because the helicopter business itself was in bad shape. But Brintel has been less successful than its two competitors. In the year ended 30 April 1998 Brintel had operating profits of £4.6 million, which represented 10 per cent of turnover and 7 per cent of its average net operating assets. In the following year, after the loss of the Shell contract, Brintel's operating profits fell to £[redacted] million, representing [redacted] per cent of turnover and [redacted] per cent of net operating assets. By comparison Bond had operating profits of £9.2 million in the year ended 31 December 1998, representing 15 per cent of turnover and 15.2 per cent of its average net operating assets; and Bristow had operating profits of £19.4 million in the 15 months ended 31 March 1998, representing 12.3 per cent of turnover and 17.7 per cent of its average net operating assets on an annualized basis (see Tables 3.9, 3.11, 3.18, 3.22 and 3.25).<sup>1</sup>

2.31. The fact that three companies survived throughout most of the 1990s might, however, have been primarily due to the actions of the oil companies. Brintel was highly dependent on its contract with Shell which told the MMC in 1992 that its decision to renegotiate a contract with BIH rather than to go out to tender had been influenced by the need to keep a third competitor in the market.<sup>2</sup> Shell took a different view when it re-let its contract for the Northern Zone in 1998. It went out to tender and the contract was won by Bristow. This had a dramatic effect on Brintel's turnover and operating profits (see paragraph 3.41). CHC told us that it had identified four options for Brintel: diversification; rationalization; consolidation, involving either the sale of Brintel or the purchase of another operator; and closure.

2.32. In practice several of these options were pursued. Brintel has been reduced in size. CHC invited HSG and Schreiner to purchase Brintel in 1998 but neither of them took up the offer. Brintel also looked for business outside the UKCS, with some success. In particular it managed to win a contract from Maersk Olie og Gas AS (Maersk) in the Danish sector of the North Sea, beating the long-standing in-house helicopter operator which has since withdrawn from the market.

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<sup>1</sup>Because of differences in the accounting policies of Brintel, Bond and Bristow, the ratios given may not be directly comparable.

<sup>2</sup>1992 report, paragraph 5.58.

2.33. Views differed on whether the market could sustain more than two players. Some oil companies and Bristow thought not. On the other hand, Stephen and Peter Bond made it clear to us that they would like to be able to take advantage of opportunities to enter as a third operator. CHC's response was more complex. It said that on the assumption that operators supplied offshore helicopter services to the UKCS only, and had no contracts elsewhere, then the Northern Zone market could sustain a maximum of two players, and the Southern Zone perhaps only one. But on the assumption that operators' overhead costs could be met either through offshore contracts elsewhere or through supplying other kinds of helicopter services, it thought that the market could sustain at least five operators. It told us that one way to operate profitably in the Northern Zone would be for a helicopter operator to have its main base elsewhere, with the overheads of this base covered mainly by other business, and merely to have a small satellite operation at Aberdeen. This, in reverse, was essentially the tactic it had employed in entering the Danish market.

2.34. If CHC is correct it is not clear to us why Brintel should not have remained as a third player in the market indefinitely provided it could have obtained sufficient business elsewhere to absorb part of its overheads, as it appeared to be doing with some success prior to the merger.

2.35. We considered whether the cost structure of helicopter operators was such that it would be difficult for them to reduce their costs in response to reduced demand and hence remain profitable. It appeared to us that the need for onshore bases and their associated maintenance and passenger terminal facilities represented a cost that would not be easy to reduce in response to reduced demand. We were told by CHC that one of the attractions of the merger was the opportunity it offered to combine the onshore bases of Bond and Brintel at Aberdeen Airport, to give an annual saving, including staff reductions, of nearly £[£] million (see Tables 3.27 and 3.28). Bristow, the largest of the helicopter operators in the Northern Zone, thought that its onshore facilities at Aberdeen Airport were underutilized.

2.36. The evidence we have examined does not provide a very clear answer to the question of whether the market could sustain more than two operators, and in particular whether Brintel would have remained in it. If demand for helicopter services were to fall further, it is quite possible that no more than two players would remain in the market irrespective of the merger. But the uncertainties are such that we are not convinced that Brintel was likely to have left the market in the absence of the merger. We are therefore unable to conclude that the merger may have been expected to have no effect on the level of competition. This applies to both the Northern and the Southern Zones.

## **Market entry**

2.37. In 1992 three helicopter companies, Bristow, Bond and BIH, had contracts in the Northern Zone; the same three companies (and no others) also had contracts in the Southern Zone. In 1999 effectively the same operators, though with new owners and a change of name in the case of BIH, still had all the contracts in the Northern Zone; in the intervening years no other operator had been able to obtain a contract there. The position in the Southern Zone is slightly more complicated: KLM ERA won a contract from Shell in 1995 but lost it again in 1998 and subsequently left the market. Brintel was unable to win any contracts in the Southern Zone after 1995 though it continued to bid for them. So in 1999 only Bristow and Bond had contracts in this zone.

2.38. The fact that the same three operators won all the contracts in the Northern Zone throughout the period 1992 to 1999 could be taken as evidence that there are barriers to entry into the market. Equally, however, it might indicate that the market is highly competitive, with existing competitors offering contract prices which potential new entrants could not beat. In

order to assess which of these possibilities was more likely we examined potential barriers to entry and identified the following main ones:

- (a) regulatory requirements;
- (b) the need for a new entrant to obtain:
  - (i) an onshore base or bases;
  - (ii) helicopters modified for use in the Northern or Southern Zones; and
  - (iii) trained helicopter crew; and
- (c) the preferences of oil companies.

We discuss each of these in turn distinguishing the Northern and the Southern Zones where necessary and noting any differences from the position in 1992.

### ***Regulatory requirements***

2.39. Helicopter operators must obtain an Air Operator's Certificate (AOC) and an Operating Licence. The AOC is concerned with safety standards whereas the Operating Licence depends on criteria such as financial fitness and adequacy of insurance; it also incorporates nationality restrictions. Up to 1992 the legal framework had the effect of restricting entry into the market to UK-controlled companies. On 1 January 1993 the European Commission substantially liberalized air transport with the implementation of its so-called 'third package', whose provisions were subsequently extended to all member states of the EEA. The third package required each EC member state to grant Operating Licences to carriers whose principal place of business was in that state, which were majority owned and substantially controlled by EEA citizens, and which met the other specified criteria.

2.40. The third package also broadly permitted any air carrier with an Operating Licence from one EEA member state to operate throughout the EEA; however, this freedom of access did not apply to certain services including those to offshore installations. Operators of services not covered by such freedom of access must obtain route licences or an exemption from that requirement. The Civil Aviation Authority (CAA) told us that it had granted such an exemption for any holder of a UK Operating Licence providing services in the UK offshore market.

2.41. Helicopter operators using aircraft not registered in the UK require the permission of the Secretary of State to provide paid-for services in the UK not covered by the freedom of access provisions of the third package. The Department of the Environment, Transport and the Regions told us that it encouraged a liberal climate by giving foreign operators access to the UK market provided that there were reciprocal rights for UK operators. Such rights had been agreed with the Danish, Dutch, German and Irish authorities.

2.42. Nationality requirements still restrict entry into EEA markets by non-EEA companies such as those from the USA and Canada. In practice this restriction does not appear to have greatly inhibited entry. We have already mentioned Mr Craig Dobbin's dual Canadian and Irish nationality which has enabled CHC to enter the UK market (see paragraph 2.3) and OLOG's 49 per cent ownership share of Bristow which has meant that OLOG and Bristow effectively act as a single global helicopter group. Two other major US helicopter companies have also entered EEA markets since 1992, although they did not remain in them: Era entered the Dutch and UK markets in a joint venture with KLM and Petroleum Helicopters Incorporated (PHI) entered the Irish market in a joint venture with Bristow.


## ***Onshore bases***

2.43. Helicopter operators providing services to the UKCS require onshore bases offering various facilities such as hangars for maintenance and storage, passenger terminals and office space. In the Northern Zone by far the most important location of these facilities is Aberdeen Airport although they are also to be found to a lesser extent at Shetland airports, principally Scatsta. In the Southern Zone onshore facilities are available at Humberside Airport, Norwich Airport and North Denes Aerodrome (owned by Bond) for North Sea operations and at Blackpool Airport for Morecambe Bay operations.

2.44. The 1992 report found that the availability of facilities at Aberdeen Airport for potential new entrants was very restricted and that this amounted to a serious entry barrier to the Northern Zone market. Because of the importance of this finding to the conclusions of the 1992 report we have looked carefully at the current position. At the time of the merger Brintel owned two hangars and a passenger terminal on land leased from Aberdeen Airport and located on the west side of the airport. Bond also owned two hangars and a passenger terminal (on land leased from Aberdeen Airport) and sub-leased a third hangar from Bristow. All of Bond's facilities were on the east side of the airport.

2.45. CHC told us that, subject to the outcome of our inquiry, its intention was to rationalize its facilities at Aberdeen Airport [

*Details omitted. See note on page iv.*

]. We think that the pressures on CHC to reduce its costs in the UK will give it a strong incentive to sell [  ] facilities at Aberdeen to whoever is willing to pay a reasonable price for them, even if that is a competing helicopter operator seeking to enter the market.

2.46. However, even if CHC is able, for whatever reason, to avoid selling any of its facilities to a competitor, it appears that such a competitor would probably be able to obtain a base at Aberdeen Airport. The airport management told us that suitable sites had already been identified for additional hangarage, should it be required by a new helicopter operator, and that if terminal and passenger handling facilities were not already available to the new entrant, the airport would have no difficulty in agreeing to helicopter passengers being processed through one of the terminals currently used for fixed wing traffic.

2.47. It might not be necessary for a potential new entrant to the Northern Zone to obtain a full set of facilities at Aberdeen Airport. We have already mentioned CHC's views that satellite operations were feasible (see paragraph 2.33). Under this arrangement a new entrant could have its main base outside the UK where it would conduct its maintenance and administration, and would retain only minimal facilities, including presumably passenger handling arrangements, at Aberdeen. The British Airline Pilots Association (BALPA) told us that it believed such an operation was feasible. CHC said that the sunk costs of a satellite operation were low, particularly when spread over the lifetime of a contract.

2.48. The present availability of facilities at Aberdeen Airport is a major change from the position in 1992. When we mentioned this to BP Amoco it expressed some surprise at the line the airport authorities were now taking. Nevertheless, the evidence we received was quite unequivocal. We do not think that we can reasonably conclude that the availability of facilities at Aberdeen Airport is currently a major barrier to entry.

2.49. The availability of onshore bases in the Southern Zone has always been less of a problem. There are three airports to choose from and when KLM ERA entered the market in 1995 it was able to obtain facilities at Norwich Airport. We do not believe that the need for onshore facilities in this zone is an entry barrier.

## ***Helicopters and crew***

2.50. The helicopters used in the Northern Zone are mainly heavy aircraft: the Eurocopter AS332L and AS332L2 (Mark I and Mark II Super Pumas) and the Sikorsky S61N, with Super Pumas generally being the oil companies' aircraft of choice. In order to be suitable for operation in the Northern Zone these helicopters must be modified in various ways (see Table 4.4).

2.51. We received conflicting views about the ease with which a new entrant would be able to obtain suitable helicopters. CHC said that second-hand Super Pumas were currently available on the market, that a new one could be obtained from Eurocopter in about ten months and that, in any case, if an existing operator lost a contract to a new entrant it would be left with helicopters for which it had no work and would prefer to lease these out rather than have them standing around earning nothing. By contrast Stephen and Peter Bond said that all the North Sea equipped Super Pumas in the market place were owned or controlled by CHC and OLOG/Bristow, and that some of the modifications required to make a helicopter suitable for operation in the North Sea were the subject of intellectual property rights owned by these companies. The Bonds also estimated that it would take 16 to 22 months to purchase and modify for North Sea use a new Super Puma. They said that when Brintel had lost the Shell contract to Bristow it had kept the helicopters it had previously used for the contract unutilized for six to nine months rather than lease them to Bristow.

2.52. We asked CHC about the availability of modifications required for North Sea operations. It told us that they consisted of two elements: the physical parts, and the design to integrate these parts into the helicopter's systems which was slightly different for each individual helicopter (even of the same type). Parts were provided by manufacturers and were available in the open market. Designs could be obtained from any one of 30 to 40 CAA-approved design organizations including Brintel, Bond and Bristow. If a new entrant wanted to use a design owned by Brintel or Bond it would be able to obtain a licence for it at the market rate.

2.53. CHC denied that it had been unwilling to lease helicopters to Bristow when Brintel lost the Shell contract. It said that, on the contrary, it had offered three Super Pumas to Bristow at market rates but Bristow had chosen to obtain the helicopters it required from other sources, including Bond.

2.54. We think that there would be a temptation for existing Northern Zone helicopter operators to behave strategically over the leasing of their helicopters and the licensing of their designs in order to signal to potential entrants that they would not find it easy to obtain North Sea-modified Super Pumas were they to win a contract in the Northern Zone. Nevertheless, we doubt whether the need to obtain suitable helicopters would amount to a major entry barrier. CHC and the OLOG group are not the only owners of Super Pumas (a little under a half of the world stock is owned by other operators), and designs for North Sea modifications could be obtained elsewhere. It would be open to an oil company which was dissatisfied with the existing operators to ensure that its contract-awarding process allowed sufficient time for a new entrant to obtain suitable helicopters. We return to the question of the oil companies' influence on market entry in paragraph 2.58.

2.55. The helicopters used in the Southern Zone, where distances and payloads are less than in the Northern Zone, are generally lighter models which are more widely available. We think that helicopter availability is less of a barrier in the Southern Zone than in the Northern.

2.56. As for helicopter pilots, we were told that because of retrenchment by UK offshore operators, pilots with relevant North Sea experience had been made redundant and could be readily obtained by a new entrant. CHC said that in the longer term there could be a pilot shortage as a result of the age profile of existing pilots, the preference of younger ones for

fixed-wing aircraft, and a drying up of the supply of pilots from military sources. These problems will need to be addressed by the industry, through training programmes and the like, but we do not regard them as entry barriers as such.

### ***Preferences of oil companies***

2.57. BP Amoco told us that it would be willing to award a contract for helicopter services only to a company which it was confident could meet the necessary safety standards. It agreed that major operators not currently in the UK offshore market, such as Era and PHI, would probably meet this requirement. CHC suggested that it was individuals rather than companies which possessed the relevant experience, implying that a new company formed by individuals who had a good offshore helicopter record would be acceptable. We think this is a fair point: if, for example, a company founded by the Bonds were to bid for offshore work at some stage, we expect that oil companies would take their bids seriously. Although the requirement to demonstrate a proven safety record will be a barrier to those seeking to supply helicopter services for the first time, and perhaps to those who have only onshore experience, it is unlikely to be a major inhibitor of market entry.

2.58. We were told by CHC that oil companies did not nowadays necessarily require bidders for their contracts to have obtained the appropriate licences and other facilities at the time of the bid. It said that Brintel had bid for the Maersk contract without a licence to operate in Denmark or base facilities there and had been awarded the contract on the understanding that it would obtain them before the effective start date, which it did. Whether or not this practice is unusual, it demonstrates that the ease with which a new operator can enter the market is to a substantial extent in the hands of the oil companies. If they are dissatisfied with existing operators it is open to them to design their tender process in such a way as to reduce barriers to new entrants. In particular, they can ask for bids sufficiently far in advance of the start of the new contract that a new entrant would have enough time to obtain licences, bases and helicopters.

### ***Potential entrants***

2.59. CHC suggested that the potential entrants to either the Northern or the Southern Zone markets included Schreiner, Heli-Union, Irish Helicopters, BAS or another company owned by Stephen and Peter Bond, and joint ventures involving either ERA or PHI and a European partner, possibly a small onshore operator. The Bonds indicated to us that they would like to be able to take advantage of opportunities for entry but were constrained by non-competition agreements that they entered into when they bought BAS from HSG. These agreements prevent BAS from competing with HSG in the offshore market for a period of five years and prevent Stephen and Peter Bond as individuals from doing so for two years (from July 1999).

2.60. Era told us that it had a continuing interest in establishing operations in the North Sea helicopter market but that it would not do so without a significant improvement in exploration and production activity in the area, with a commensurate pricing structure to provide a fair return on its investment. Some of the other companies named do not seem very likely entrants: for example, we were told that Heli-Union is mainly engaged in the leasing of helicopters to operators in developing countries.

### ***Conclusions on entry***

2.61. There have been two critical changes to entry conditions since the 1992 report: the liberalization of the EEA market which has permitted non-UK-controlled companies to enter the UK offshore market; and the availability of onshore bases at Aberdeen Airport. In view of

these changes we do not believe that we can reasonably conclude that either the Northern or the Southern Zone is difficult to enter. On the contrary, they both appear to us to be contestable markets which offer scope for hit-and-run entry on a contract by contract basis provided only that customers, namely the oil companies operating on the UKCS, are willing to support it. The entry to and subsequently exit from the Southern Zone market by KLM ERA is an illustration of what can happen. The fact that more such entry did not occur, and none in the Northern Zone, is more likely to be an indication of the unattractiveness of the market in terms of its profitability than it is of entry barriers.

## **Effect of the merger on competition**

2.62. Competition to supply offshore helicopter services takes the form of competition to win contracts with oil and gas companies. Although some services are supplied outside the framework of long-term contracts they are a small proportion of total supply. There was general agreement among those who gave us evidence, including the oil companies, that prior to the merger (when there were normally three companies competing for contracts in the Northern Zone and three or four in the Southern Zone) these markets were highly competitive. The extent of competition is illustrated by the fact that a number of major contracts have changed hands in the last 18 months. The question that we must address is whether there will be a material reduction in competition as a result of the merger.

2.63. Unless there is new entry the merger will create a duopoly in the Northern Zone. The extent to which duopolists engage in genuine competition varies widely from market to market. Broadly speaking we would expect competition to be more intense when there is broad parity in size and cost structure between the duopolists and when there is independence of pricing. Brintel/Bond and Bristow are of broadly the same size; we have no evidence to suggest that their cost structures vary greatly, although Bristow told us that it thought that its costs might be greater than its competitors'.

2.64. Independent pricing by duopolists can be undermined in two ways. First, the two companies may develop a close relationship which may lead, in the extreme case, to full collusion. Second, the companies may keep at arm's length from one another but independently conclude that it would not be in their interests to compete too strongly and decide to set their own prices by reference to the prices of the other, though without collusion. We look at both of these possibilities in turn.

2.65. We were told that CHC had sold OLOG 12 helicopters formerly belonging to HSG. Three of the helicopters sold were engaged in an Irish search and rescue contract and were leased back to CHC to permit it to fulfil its contract obligations, pending a possible assignment of the contract to Bristow to which CHC had asked the Irish Government to agree. OLOG's purchase assisted CHC to acquire HSG. As this acquisition will make CHC a larger and stronger company, OLOG's action might not appear on the face of it to be in its interests as a competitor. We were concerned that this transaction might be symptomatic of a close relationship between CHC and OLOG which would predispose both of them not to compete too strongly.

2.66. CHC told us that the sale of helicopters to OLOG had been forced on it by financial necessity. It had had to borrow heavily to finance its acquisition of HSG and its bankers told it that it must reduce its debt quickly by selling assets. OLOG was probably the only company in the world which was able and willing to buy 12 helicopters as a single package. CHC said that although it might have been able to raise as much money by selling smaller numbers of helicopters to several different buyers there was simply no time to arrange a complex series of transactions. OLOG had used the strength of its position to strike a hard bargain and there were several aspects of the transaction which CHC would have avoided if it had believed that it could have done so without endangering the sale. For example, it would have preferred to sell

S61Ns for which it had no work rather than those engaged on the Irish search and rescue contract, but OLOG had insisted that the helicopters it bought should come with a stream of income. CHC insisted that the bargain it had struck with OLOG had been a tough one and that there was nothing ‘cosy’ about the relationship between the two companies. It said that OLOG had certainly not been a party to CHC’s decision to acquire HSG and in agreeing to buy the 12 helicopters it had simply been using the opportunity of CHC’s need for cash to strike a shrewd business deal.

2.67. Bristow, speaking on behalf of OLOG, confirmed CHC’s account of the sale. Having reviewed the evidence, we are of the view that the transaction between CHC and OLOG was a normal commercial deal in which both sides sought to secure the maximum business advantages for themselves. We have been unable to find any basis for believing that favours were done by one side or the other.

2.68. We looked into the extent to which CHC and OLOG overlapped in markets elsewhere in the world, and might therefore have contact on a global basis. At first sight the extent of overlap appeared small. Apart from the NWECS, both companies are present only in Brazil, the Timor Sea and Azerbaijan. However, we were told by CHC that it was not necessary for a helicopter operator to have an established base in a country in order to compete for contracts there, and that the number of markets in which CHC and OLOG competed was greater than at first appeared the case. Frequent contact might encourage the two companies to reach an understanding. Alternatively the constant process of head-to-head competition for discrete time-limited contracts (for which there would be only one winner) might sharpen their global rivalry.

2.69. We found no evidence which suggested that CHC and OLOG had an over-close relationship. We were told by CHC that, at the global level, there was a constantly changing pattern of market entry and exit by helicopter operators in response to the success or failure of contract bids. BALPA told us that in its experience CHC and OLOG competed strongly elsewhere in the world. In the UK, CHC’s subsidiary Brintel and OLOG’s associate Bristow competed vigorously in the offshore market prior to the merger.

2.70. The second possibility mentioned in paragraph 2.64, namely that Brintel/Bond and Bristow might set their own prices by reference to the prices of the other, but at arm’s length (that is, without any collusion or undue closeness of relationship being involved), is of its nature a difficult one to assess. We think that such behaviour by duopolists will be more likely when entry to the market is difficult, prices are transparent so that each duopolist knows what the other is charging, there are frequent opportunities to adjust prices, and there is a lack of spare capacity. Price competition will also be less likely when the products of competitors are clearly differentiated from one another.

2.71. We have examined entry barriers already. We received conflicting evidence about the existence of price transparency. CHC denied that Brintel knew the prices in the contracts run by its competitors but thought that prices were transparent to oil companies. BP Amoco denied that it knew the prices in the contracts of other oil companies but said that there was a freelance publication in Aberdeen which gave an indication of contract rates. We suspect that the truth is that although no one strictly speaking ‘knows’ the prices in contracts other than their own, there is a good deal of well-informed speculation. If so, this would help Brintel/Bond to base its prices on those of Bristow and vice versa.

2.72. The other factors, however, work in the opposite direction. Prices are set in contract negotiations which are relatively infrequent events. Once a contract has been lost, it is lost for a period of years and the loser cannot make good the damage by a quick readjustment of prices. In the absence of collusion the duopolists will therefore have an incentive to bid their best price for each contract, at least while they have any spare capacity. It would appear that both Brintel/Bond and Bristow do have spare capacity at present. Independent pricing is reinforced

by the fact that the tendering process typically uses sealed bids and because there is often a period of negotiation after a bid has been accepted. Finally, the services offered by the two operators are largely undifferentiated so that they are likely to win or lose contracts mainly on price.

2.73. CHC argued that competition between two helicopter operators would be sufficient to prevent prices rising as a result of the merger. In support of this view it drew our attention to the Norwegian offshore market, where there have been two competitors in recent years. Offshore helicopter services are generally more expensive in Norway than in the UK Northern Zone. However, CHC sent us a paper by Lexecon Ltd which found that once rates for these services were adjusted in various ways for differences in variable costs between the two markets there was no evidence that they were higher in Norway (see paragraph 4.51).

2.74. Taking into account our earlier conclusions on market entry, we see no reason to believe that Brintel/Bond and Bristow would not engage in independent pricing, and to that extent there would be genuine competition between them. Nevertheless, it seems to us likely that there would be some loss of competition arising from the reduction in the current number of competitors. Whether this loss of competition will have adverse effects depends to a great extent on whether the oil companies have sufficient buyer power to counteract it. We consider this question in the next section.

## **Buyer power**

2.75. The customers of offshore helicopter operators, the oil and gas companies engaged in exploration and production on the UKCS, are a relatively small group (we identified less than 20 companies with major helicopter contracts) of experienced and sophisticated buyers. Within this group purchasing power is concentrated: BP Amoco and Shell account for almost half of the total value of contracts. Oil companies are also much larger and commercially stronger organizations than their suppliers. For example, Enterprise Oil plc, one of the smaller oil companies, has a market capitalization of around £2 billion; by contrast, OLOG, which we were told was the largest provider of helicopter services in the world, has a market capitalization of around £120 million. CHC argued that recent consolidation in the oil industry, such as BP's merger with Amoco and Exxon's with Mobil, and prospective consolidation, including proposed mergers between BP Amoco and Arco, and between Total and Elf, was strengthening the position of the oil companies.

2.76. The generally low level of oil prices throughout most of the 1990s (see Figure 4.3) has forced oil companies to pay more attention to the level of their supply costs in relatively high-cost areas like the UKCS. There is evidence to suggest that in recent years they have become more determined to use their buyer power to force down these costs. The CRINE initiative (Cost Reduction In The New Era), which started in 1992, and its successor, LOGIC, have focused the attention of the oil companies on cost reduction. Whether as a result of these initiatives or for other reasons, revenue per flight hour for helicopter services in the Northern Zone reduced by an average of 3.75 per cent a year in real terms over the period 1996 to 1999; the equivalent figure for the Southern Zone was 2.3 per cent (see Table 4.9).

2.77. In addition contract terms have become more onerous for helicopter operators. In 1991 85 per cent of contracts, by value, were of an exclusive or sole use type. Under these contracts a specified number of aircraft were allocated to the client who paid a monthly standing charge for their availability plus a rate per flying hour when they were used. Exclusive contracts have been progressively replaced by what CHC calls 'pay-as-you-use' contracts. Under these contracts there are no standing charges or any guaranteed utilization of aircraft by the customer. The effect of these changes has been to transfer business risk to the helicopter operators although at the same time, by abolishing dedicated aircraft, they probably provide operators with the opportunity for more efficient utilization. We estimate that some 35 per cent of

contracts, by value, were of the pay-as-you-use type in 1999, and that exclusive contracts had fallen to about 55 per cent of the total (see Table 4.3).

2.78. The tightening of contract prices has been reflected in the profitability of helicopter operators. Bond's operating profits from its aircraft dedicated to Northern Zone operations declined by [§§] per cent between 1996 and 1998 (see Table 3.21) and Brintel's operating profits for its activities in the Northern Zone declined by [§§] per cent over broadly the same period (see Table 3.13). In Brintel's case the decline in profitability was greatly exacerbated by the loss of the Shell contract in 1998. We do not have equivalent figures for Bristow but it told us that it was not at present very profitable. From the views put to us there appears to be a widespread perception in the industry that operators are not currently achieving sufficiently good returns to support an adequate investment in new aircraft. Era's comment that it would not wish to re-enter the UK offshore market unless prices improve is indicative of this perception.

2.79. Helicopter operators told us of other features of their transactions with oil companies which, in their view, demonstrated the buyer power of the latter. These included their willingness and ability to drive down prices in post-tender negotiations, their imposition of contract terms which permitted customers (but not helicopter operators) to terminate contracts early, and their ability to secure advantageous changes to contract terms during the lifetime of a contract. CHC and Bristow cited several examples of contracts in which Brintel, Bond or Bristow had felt obliged to reduce prices or otherwise change contract terms in response to pressure by oil company customers. We were also told that the volume of services taken by [ § ] in its contract with Bristow was significantly less than the amount envisaged when the contract had been awarded in [ § ].

2.80. We do not think that it would be credible to contend that the buyer power of oil companies was anything less than substantial. No one who gave us evidence did, in fact, make such a contention. The critical question, however, is whether this buyer power is sufficient to overcome any adverse effects that the merger might have on competition. In the 1992 report the MMC commented that the bargaining power of oil and gas companies would be offset by their need to secure an essential service. It thought that encouraging a new entrant would involve costs and an element of risk and would not be undertaken by oil companies until prices had risen, perhaps substantially.<sup>1</sup> This conclusion reflected in part the pessimism of the MMC in 1992 about entry barriers. As we have already said, changes since then, in particular the greater availability of onshore facilities at Aberdeen Airport and greater use of satellite operations, suggest that entry is no longer seriously constrained. We also believe that, compared with 1992, there is now more reason to expect oil companies to use their buyer power aggressively, because of their greater emphasis on cost control.

2.81. We asked BP Amoco (one of the few oil or gas companies with objections to the merger) whether it could not protect its position through the encouragement of new entry. It thought that it would be difficult to do so. On the other hand, Shell told us that if the merger were to lead to higher prices or a poorer service it would encourage other helicopter operators to enter the area through participation in the competitive tendering process.

2.82. It seems likely to us that oil companies could encourage new entry without undue difficulty and would do so if they felt that existing operators were charging too much or otherwise offering an unsatisfactory service. This appears to have happened in the past: for example, we were told that Shell encouraged KLM ERA to bid for a contract in the Southern Zone in 1995. The fact that it has not been a more frequent occurrence probably reflects the success of the oil companies in keeping down the prices of the existing operators. Moreover, because new entry promoted by oil companies is a credible threat it may be expected to

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<sup>1</sup>1992 report, paragraph 1.7.

influence the behaviour of the existing operators, making them less inclined to take advantage of any reduction in competition arising from the merger, even in the absence of any actual new entry.

2.83. The proposition that the oil companies could use their buyer power to offset any adverse effects arising from the loss of competition is perhaps supported by the response of these companies to our inquiry. We wrote to 21 oil or gas companies operating on the UKCS asking for their views on the merger. Eight did not reply or else said that they had no comment. Of those who expressed a view, BP Amoco and Conoco (UK) Ltd (which also replied on behalf of Britannia Operator Ltd) thought the merger would be harmful; eight of the others were broadly neutral and two thought it would be beneficial (see paragraphs 6.2 to 6.29).

2.84. In the light of this evidence we conclude that the buyer power of oil and gas companies will be sufficient to prevent any reduction in competition arising from the merger leading to higher prices than would otherwise be the case, or other adverse effects.

## **Other consequences of the merger**

2.85. CHC told us that the merger would enable it to achieve total cost savings and other synergies of nearly £[§<] million a year, offset by one-off costs of about £[§<] million. Some £[§<] million of these savings would arise from the integration of Brintel and Bond (see Tables 3.27 and 3.28). We asked CHC how many of these savings would be passed on to customers. It told us frankly that it hoped they would be as few as possible. Realistically we think that, so far as the UK is concerned, the oil companies will be able to extract at least some of them in future contract negotiations.

2.86. Many of the savings from the merger of Bond and Brintel arise because of staff reductions. CHC told us that it expected [ §< ] to be lost, mainly in the [ §< ] area (see paragraph 3.75). We received very few representations about job losses. Despite the employment effects of the merger several of those representing local interests, including BALPA, Aberdeen Chamber of Commerce and the MP for Aberdeen Central, Mr Frank Doran, thought that it would be beneficial because it would promote greater stability and investment in the offshore helicopter industry.

## **Conclusions on the public interest**

2.87. Our conclusions on the four questions posed in paragraph 2.22 are as follows:

- (a) While there is evidence to suggest that the market for helicopter services to oil and gas installations on the UKCS is shrinking, we are not convinced that Brintel was likely to have left the market in the absence of the merger. We are therefore unable to conclude that the merger may have been expected to have no effect on the level of competition in either the Northern or Southern Zones.
- (b) Entry barriers are, however, not so high that entry by another operator is unlikely even if prices were to rise after the merger. On the contrary, both the Northern and Southern Zone markets are contestable. Unlike in 1992, it is no longer credible to argue that a shortage of onshore facilities at Aberdeen Airport would constrain entry to the Northern Zone, particularly given the possibility of a satellite operation.
- (c) We have not found evidence which would support the view that there is an unduly close relationship between CHC and OLOG/Bristow. There are some reasons to expect that competition between these companies in UK offshore markets will continue to be reasonably vigorous. Nevertheless, we think it is likely that there will be some loss of

competition arising from the reduction in the current number of competitors as a result of the merger.

(d) But the buyer power of the oil and gas companies will be sufficient to prevent this reduction in competition having adverse effects. The control by the oil and gas companies of the procurement process, including their ability to encourage new entry, and the fact that this is a credible threat, will constrain the behaviour of the remaining helicopter operators.

2.88. Accordingly, we conclude that the acquisition of HSG by CHC does not operate against the public interest and may not be expected to do so.