

## **STAGECOACH ACQUISITION OF PRESTON BUS IS REFERRED TO THE COMPETITION COMMISSION**

### **1 BACKGROUND**

- 1.1 On 28 May 2009, the OFT referred Stagecoach's completed acquisition of Preston Bus Limited ("Preston Bus") to the Competition Commission (the "CC"). Pre-merger Stagecoach operated intra-urban, inter-urban, commercial and tendered bus services in the Preston area. Preston Bus provided tendered and commercial services in the Preston area. The OFT clearly states that the merger was investigated of its own volition, i.e. Stagecoach did not notify the merger to the OFT voluntarily.

### **2 JURISDICTION**

- 2.1 Despite similar arguments on the part of Stagecoach as raised in the case of *Eastbourne Buses/Cavendish*<sup>1</sup>, the OFT claimed jurisdiction on the basis of the share of supply test. The parties' combined share of commercially operated intra-urban services in the city of Preston is over 80 per cent, measured by mileage.

### **3 MARKET DEFINITION**

- 3.1 In previous bus merger decisions, rather than focus on market definition, the OFT considered the competitive effects of the merger on a flow-by-flow basis. In this case the OFT appears to have considered the effects of the merger on intra-urban, tendered and inter-urban services. Considering tendered services, the OFT identified 'a large number' of other operators of tendered services in Preston besides the parties. Lancashire County Council had no concerns and the OFT concluded competition concerns were unlikely to arise with tendered services.
- 3.2 In terms of inter-urban services, unlike Stagecoach, Preston Bus did not provide any inter-urban services. The OFT considered that inter-urban services<sup>2</sup> are unlikely to be a constraint on intra-urban services in Preston. Inter-urban services were not considered further as the overlap flows for inter-urban services often account for less than 10 per cent of route revenue, and would therefore in any event be excluded using the CC's filter methodology.
- 3.3 The OFT considered intra-urban services in some detail. Pre-merger Stagecoach operated 20 commercial services in Preston and Preston Bus operated 18 services. Stagecoach submitted that on the traditional flow-by-flow analysis only eight flows would remain for consideration. However, the OFT considered two different analytical approaches. The first approach seems to be based on the traditional flow-by-flow approach. However as well as assessing actual overlaps it also assessed potential competition between the parties on those flows where only one party was present but the other operated close by.
- 3.4 The second approach involved the OFT "*defining numerous flow-specific markets but aggregating them for the purposes of its competitive assessment under the rubric of 'intra-urban commercial bus services in north Preston' .. to encompass both overlapping and non-overlapping flows between the parties*".<sup>3</sup> The rationale for that approach appears to be that the parties' networks overlapped extensively with many routes running on, or close to, those of the other. Only actual overlaps would be caught by the traditional analysis, whereas the OFT considered that even on flows where the

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<sup>1</sup> Stagecoach claimed that Preston was not a 'substantial part of the UK' with a population of 131,000.

<sup>2</sup> Given that they tend to operate, and stop, less frequently.

<sup>3</sup> Paragraph 19, OFT decision on the Completed acquisition by Stagecoach Group plc of Preston Bus Limited.

parties did not directly overlap it would have been relatively easy for the parties to alter or add to existing services to compete head-to-head with each other thereby imposing an effective constraint on each other by offering potential competition. The OFT considered it would be appropriate to aggregate all (overlapping and non-overlapping) flow markets and assess the merger on the basis of an overall market for north Preston.

- 3.5 Other forms of transport, including coach, walking, cycling, taxis and private cars, did not compete with commercial local bus services in Eastbourne.

## **4 COMPETITIVE ASSESSMENT**

### **The counterfactual**

- 4.1 The merger needs to be assessed against the appropriate counterfactual (i.e. what would have happened absent the merger). This is often taken to be the prevailing conditions of competition pre-merger. The prevailing conditions of competition were that Stagecoach and Preston Bus were competitors in the local commercial bus market in Preston. However, Stagecoach submitted that Preston Bus was failing and that this should be taken into account.
- 4.2 The 'failing firm' defence will only be satisfied, and the merger therefore not referred, where there is compelling evidence that the following conditions are met:
- (a) absent the merger, the target business would have inevitably exited with no serious prospect of re-organisation; and
  - (b) there was no realistic and substantially less anti-competitive alternative to the merger.
- 4.3 The OFT did not conclude on the first limb as it found that there was a realistic and substantially less anti-competitive alternative to Stagecoach acquiring Preston Bus, meaning that the test could not be satisfied. On the evidence before it the OFT considered that there would have been no other realistic purchaser of Preston Bus if Stagecoach had not acquired it as no other bidder was willing to take on the significant pension fund deficit. The OFT considered 'what if' Preston Bus could not be sold as a going concern and was instead liquidated<sup>4</sup>. It concluded that if Preston Bus was liquidated (with albeit some short-term consumer detriment in the meantime), almost any other company acquiring some of the assets and operating commercial local bus services in Preston would have been a substantially less anti-competitive alternative to Stagecoach.
- 4.4 In relation to the first limb, whilst the OFT acknowledged that Preston Bus was in severe financial difficulties at the time of the sale it nevertheless considered it plausible that, even though complicated, Preston Bus may have been willing and able to reorganise. However, reorganisation was never considered in detail because Preston Bus chose to pursue a sale instead.
- 4.5 In a counterfactual where Preston Bus' assets were acquired by another purchaser the OFT considered it appropriate at Phase 1 to use Preston Bus as a proxy for the purchaser of the assets albeit that the purchaser may reduce the frequency and coverage of services. The acquisition was therefore assessed against the prevailing conditions of competition, i.e. Preston Bus' continued operations.

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<sup>4</sup> With the pension fund deficit transferring to Preston City Council.

### **Horizontal issues**

- 4.6 Assessed against the counterfactual, and the fact that pre-merger the parties' networks overlapped extensively, the OFT concluded that absent the merger Stagecoach would have been constrained by Preston Bus, or a purchaser of its assets. This competition has been lost as a result of the merger.
- 4.7 In addition to the removal of actual competition between the parties the OFT concluded that the parties were also the most likely potential competitors to each other and that this constraint was lost as a result of the merger. It does appear that the OFT reached these conclusions having used the traditional flow-by-flow analysis although it stated that it considered that the outcome of its competitive assessment would have been the same if assessing the merger on the basis of an overall market for north Preston.

### **Barriers to entry**

- 4.8 Whilst it appears the evidence suggested there were sufficient sites available to establish a depot the OFT concluded that the potentially significant investment required to establish a depot (£2 million was quoted) might constitute a significant barrier to entry.
- 4.9 The OFT also considered network effects. It did not conclude on whether network effects constituted a barrier to entry. The OFT's theory of harm is that in markets where a significant proportion of consumers take more than one service to reach their final destination, networks can represent a barrier to entry if new operators are required to enter on multiple routes in order to be competitive. Pre-merger Stagecoach derived only 0-10 per cent of its revenue from multi-trip tickets with Preston Bus deriving 10-20 per cent. Stagecoach submitted that a very small proportion of journeys involve more than one bus with the majority of network tickets being used as a cost effective way of purchasing multiple single tickets. In terms of the latter point, the OFT considered such ticketing unlikely to comprise a barrier to entry.
- 4.10 Nevertheless, the OFT was unable to identify any operators likely to enter or expand to compete with Stagecoach. Therefore the duty to refer arose in relation to the intra-urban commercial bus market in Preston.

## **5 EXCEPTION TO THE DUTY TO REFER**

### **De minimis**

- 5.1 Stagecoach argued that the OFT should apply the 'de minimis' exception on the basis that the value of the market was significantly less than £10 million per annum.
- 5.2 Looking at the size of the market affected, Stagecoach was of the view that only the flow revenues on the eight overlap flows left after applying the CC filters, at just under £5 million, should be relevant. The OFT disagreed. Consistent with the OFT's 'second approach' (see paragraph 3.4 above) the affected market was either (a) all routes in north Preston as well as overlapping routes in the south west of Preston amounting to £14 million, or (b) 14 affected routes predominantly to the north of the city, amounting to just over £10 million. Therefore the OFT would not exercise the 'de minimis' exception.

**Burges Salmon LLP**