

# OFT refers three Stagecoach acquisitions to the Competition Commission

The OFT has recently referred Stagecoach's acquisitions in Eastbourne (Eastbourne Buses and Cavendish) and Preston (Preston Bus). In Eastbourne, Stagecoach became the monopoly supplier as a result of the two acquisitions and, in Preston, Stagecoach increased its share to over 80% of the market. Whilst it is not perhaps surprising that the transactions were referred, this is the first time the OFT has referred a local bus services merger since Arriva / Sovereign in August 2004.<sup>1</sup>

Since 1 January 2006, and discounting the two Stagecoach references, the OFT has considered 14 local bus mergers – it found that 3 did not qualify and cleared the remaining 11 at Phase 1. It appeared therefore that the OFT had been more willing to clear local bus mergers on the grounds that barriers to entry were low and any potential competition concerns could be overcome by new entry or expansion by existing competitors. The recent Stagecoach references may indicate that the OFT's approach is hardening.

The Competition Commission ("the CC") has set itself a September 2009 deadline to publish its final report on the Stagecoach / Eastbourne Merger Inquiry and October 2009 for the Stagecoach / Preston Merger Inquiry.

Running in parallel is the OFT's market study into local bus services announced in March 2009. One of the factors mentioned in the OFT's press release announcing the market study was that, "The sector has become increasingly concentrated by takeovers with nearly two thirds of services now controlled by five large operators." The OFT states that it may be in a position to publish its findings by October 2009 although it will provide an update on timing later this Summer. The Stagecoach references may actually compound any competition concerns the OFT already has – the subtext to Stagecoach's arguments is that in smaller towns and cities there is only room for a monopoly operator. If that is the case, does that open up the industry to calls for more regulation?

In this briefing we highlight some of the more noteworthy points arising out of the OFT's decisions. More extensive notes on each of the OFT's decisions are available at:

[http://www.burges-salmon.com/Practices/commercial/Competition/Publications/Stagecoach\\_acquisition\\_of\\_Eastbourne\\_Bus\\_referred\\_to\\_Competition\\_Commission.pdf](http://www.burges-salmon.com/Practices/commercial/Competition/Publications/Stagecoach_acquisition_of_Eastbourne_Bus_referred_to_Competition_Commission.pdf)

and

<http://www.burges-salmon.com/Practices/commercial/Competition/>

<sup>1</sup> That merger was cleared by the Competition Commission.

<sup>2</sup> Although the notification of mergers in the UK is voluntary, the OFT retains the power to initiate its own investigation where a merger situation comes to its attention.

<sup>3</sup> Turnover of the target in the UK is over £70 million.

<sup>4</sup> The merged entity increases its market share to at least 25% in the UK or a substantial part of it.

<sup>5</sup> Including 19,000 in nearby Hailsham

[Publications/Competition\\_Commission\\_Stagecoach\\_acquisition\\_of\\_Preston\\_Bus.pdf](#)

## The OFT investigated Preston Bus of its own volition

After a protracted period of often aggressive competition between the two, Stagecoach acquired Preston Bus on 23 January 2009 at a time when Preston Bus was in severe financial difficulties. The acquisition gave Stagecoach over 80% of the Preston local bus market. In the decision the OFT expressly states that the merger was being investigated of its own volition i.e. Stagecoach had not voluntarily notified the merger.<sup>2</sup> Given the publicity around the recent competitive activity in Preston, and at times the intervention of the Traffic Commissioner, it is perhaps not surprising the OFT picked this one up. Nevertheless it does confirm the OFT's interest in local bus mergers and that non-notified mergers run the very real risk of being investigated.

## Further reminder that small acquisitions are not beyond the OFT's grasp

For the OFT to have jurisdiction to investigate a merger it must either satisfy a turnover test or a share of supply test. The vast majority of bus acquisitions are unlikely to meet the turnover test<sup>3</sup> and therefore it will be the share of supply test that is usually most relevant<sup>4</sup>. This test needs to be met in a "substantial part of the UK". Previously the OFT found that Slough, with a population of approximately 120,000, constituted a substantial part of the UK. In the present case, Preston (approximately 131,000) and Eastbourne (approximately 114,000<sup>5</sup>) were also considered to be a substantial part of the UK. Therefore any acquisition of routes around a town or city in the UK of a similar or greater size are potentially caught.

Stagecoach also raised the de minimis exception in both cases but did not succeed on either. In its Guidance on the topic, the OFT has stated that it would generally consider the market to be of insufficient importance to justify a reference below the £10 million market size threshold (although there are caveats to that). The OFT disputed that the market affected in Preston was in fact worth less than £10 million. In Eastbourne, whilst the size of the market affected was just over £6 million the evidence pointed towards the impact of the merger being significant and therefore the OFT did not apply the de minimis exception.

## OFT's approach to assessment of competitive effects of local bus mergers developing?

The OFT has traditionally focused on the effects of bus mergers by looking at the parties' actual route overlaps on a flow by flow analysis applying certain filters. This approach has evolved from previous CC cases. The focus therefore is on local bus service competition. The OFT does not consider that other transport modes compete with bus although the OFT does contemplate the possibility that on some flows rail may be a substitute for bus. In some cases the competition authorities have also considered the effects based on network markets.

In the case of Eastbourne where the merger created a monopoly, the OFT felt that assessing the merger on a network-wide basis was more pragmatic. In Preston, the OFT appears to have used the traditional flow by flow approach. However as well as assessing actual competition on overlaps the OFT also assessed the potential for competition between the parties on the flows where only one party was present but the other operated close by. This approach extends the OFT's traditional approach, which may in fact reveal few overlaps where actual competition will be lost as a result of the merger. However, with two large contiguous operators the loss of potential competition could be significant. Of course if the OFT is inclined to see the parties to the merger as providing significant potential competition to each other it should also assess potential competition from other operators in the area within similar proximity.

In Preston, the OFT also refers to an alternative assessment approach by aggregating all (overlapping and non-overlapping) flow markets and assessing the merger on the basis of an overall market for north Preston. This appears to suggest some sort of corridor approach although this is not at all clear from the OFT's decision.

Extending the traditional approach has the potential to increase significantly the amount of data required by the OFT at Phase 1. This appears to be the case particularly in situations where there is little actual overlap between the parties' services but they operate in the same or contiguous areas. No doubt the CC's analysis, once it is published, will inform the OFT's future approach so that bus operators contemplating mergers will know if the method for assessing a merger, and therefore the data required by the OFT at Phase 1, has in any way changed from the traditional flow by flow approach.

### The 'failing firm' defence

The statutory test applied by the OFT to determine whether or not the duty to refer arises needs to be assessed against the appropriate counterfactual i.e. what would have happened absent

the merger. In most cases this will be straightforward and consist of the prevailing conditions of competition.

The appropriate counterfactual was debated at some length in both OFT decisions. In both cases, Stagecoach raised the "failing firm" defence but this was dismissed by the OFT. In the case of Preston, the OFT acknowledged that Preston Bus was in severe financial difficulties at the time of sale. It was also obvious that Stagecoach was the only bidder that was willing to take on Preston Bus including the pension fund deficit (bids for Preston Bus by Arriva and Go-Ahead excluded the pension liability). Absent Stagecoach acquiring Preston Bus it was acknowledged that it would have gone into administration and possibly liquidation. In those circumstances, the OFT concluded that absent the acquisition by Stagecoach it could not rule out the possibility that had Preston Bus gone into liquidation that another bidder (the OFT hinted at Go-Ahead) would have been successful in acquiring at least some of Preston Bus' assets and used them to compete in Preston.

Therefore, even in situations where the target is heading for insolvency at the time of the acquisition the 'failing firm' defence may not save a merger from a referral.

### Barriers to entry

There are two points of note here of relevance in future acquisitions:

- entry – in the Eastbourne decision, the OFT concluded that small scale entry (of which there was a previous example) may no longer be viable following acquisition by Stagecoach since any new entry would be competing against a 'well resourced' Stagecoach. Therefore the minimum requirements for a viable, sustained entry had been increased by the merger. In neither case could the OFT identify any operators likely to enter or expand to compete with Stagecoach; and
- network effects – the OFT considers it unlikely that multi-trip tickets would be a barrier to entry where a very small proportion of journeys involved more than one bus with the majority of network tickets being used as a cost effective way of purchasing multiple single tickets. In the Preston case, pre-merger Stagecoach derived only 0 – 10% of its revenue from multi-trip tickets and Preston Bus 10 – 20%.

If you would like to discuss this topic in more detail, or how UK merger control may impact any potential acquisition, please contact Laura Claydon on 0117 939 2273 or email her at [laura.claydon@burges-salmon.com](mailto:laura.claydon@burges-salmon.com) or Andrew Borer on 0117 939 2263 or email him at [andrew.borer@burges-salmon.com](mailto:andrew.borer@burges-salmon.com).