

GROUPE EURO TUNNEL S.A. AND SEA FRANCE S.A. MERGER INQUIRY

REMARKS ON THE PROVISIONAL FINDINGS REPORT

On 7 November 2012, the Autorité de la concurrence authorised the acquisition by the Groupe Eurotunnel SA (hereinafter “GET”), subject to certain undertakings, of some of the assets of the SeaFrance SA company (hereinafter “SF”). This acquisition, notified to the Autorité on 4 May 2012, took place in the context of SF’s judicial liquidation proceedings, whereby the Commercial Court of Paris decided to sell some of SF’s assets, in particular three ships. Having received several takeover offers for various combinations of SF assets, the Paris Commercial Court, in a judgement handed down on 11 June 2012, designated GET as the company to take over the assets of SeaFrance. On 20 August 2012, GET launched a cross-Channel ferry service on the Calais-Dover route, under the name of MyFerryLink (hereinafter “MFL”).

In its decision, the Autorité considered that GET was liable to use its strong position in cross-Channel transport via the Tunnel to promote its MFL offer, by offering packages combining both modes of transport (ferry and train). Indeed, for the transport of goods, most forwarders use both modes of transport and might thus be interested in the pricing advantages resulting from the purchase of a combination of rail and ferry crossings. The Autorité considered that the advantage thus conferred on MFL in comparison with the other ferry operators could act as a disincentive to the latter and cause them to reduce capacity or even close down certain routes (especially those opened recently).

Consequently, GET has undertaken, for a period of five years, not to grant any discounts on freight rates for cross-Channel rail transport, subject to the condition that the customer also uses MFL services. In particular, when negotiating an annual rail freight rate it must not be

allowed to take account of the freight volumes carried by MFL. More generally, GET has undertaken not to discriminate, in any way whatsoever, against customers not using MFL for their cross-Channel freight transport via ferry. In order to ensure that these commitments are effective, the prices offered to freight customers will have to be negotiated by separate sales teams for each mode of transport, and sales will be the subject of separate contracts. An independent trustee has been appointed to monitor these commitments. In view of this, the Autorité did not consider it necessary to launch an in-depth investigation phase.

For its part, the Provisional Findings Report published on 19 February 2013 by the Competition Commission dismisses the risk that the operation might lead GET to support MFL's operations by means of a combined ferry/Tunnel offer, especially on the grounds that the undertakings given to the Autorité de la concurrence would now forbid such a strategy to be implemented.

In its 7 November decision, the Autorité de la concurrence also ruled out the risk that the launch of a ferry offer by GET would allow it to increase its prices for the Tunnel in a profitable way, due to the switch to MFL ferries of part of the demand currently served by the Tunnel. The Autorité indeed noted that the competing ferry operators, P&O and DFDS/LD Lines (hereinafter "DFDS") have considerable excess capacity which would enable them to acquire a significant share of the demand that could be diverted from the Tunnel if GET increased its rail freight charges.

The Provisional Findings Report, issued following an in-depth examination conducted since last November, has reached different conclusions on this point. At this stage in its analysis, the Competition Commission considers, in fact, that it could reasonably be expected that, as a result of this operation, DFDS would withdraw from the Calais-Dover route into which this operator entered after its bid was rejected by the Paris Commercial Court. Furthermore, the Provisional Findings Report identifies risks of unilateral effects, such as greater incentive for GET to increase the price of travel through the Tunnel, since it would be likely to recover some of the losses from the MFL business. The Provisional Findings Report also concludes that GET would not be incentivised to increase price competition between MFL and the other ferry operators since a price reduction on the ferries would have repercussions on the price of crossings via the Tunnel.

The Autorité de la concurrence is very interesting in these provisional conclusions since the examination performed by the Competition Commission covered the same activity and the same geographical location as that performed by the Autorité in its decision of 7 November 2011. Indeed, the relevant markets identified appear, at this stage, to be identical in both investigations. We consider it to be particularly important, in view of the guide to good practice for cooperation between the European Union's national competition authorities concerning concentrations, adopted and published by all these authorities on 8 November 2011, to continue to operate an exchange of views between our two authorities, such as those already held with the Office of Fair Trading prior to the adoption of the 7 November decision. As you know, the main purpose of these good practices is to ensure the consistency of the decisions taken by different authorities. They should, at the very least, make it possible to explain the origin of apparent differences in the analyses (differences in the applicable legislations, in the analytical instruments used, in the creation of the dossier on which the analysis was based or the relative weight given to its various constituents, etc.).

To this end, the Autorité de la concurrence wishes to make the following observations, arranged in the same way as the plan of the report.

1. Counterfactual

The operation is the result of the implementation of the decision handed down on 11 June 2012 by the Paris commercial court, which granted the SF's assets to GET. In the decision of 7 November 2012, the Autorité de la concurrence considered that the situation that would have resulted had the Paris commercial court taken a different decision could not be accepted as a credible counterfactual in view of that fact that it was of too hypothetical a nature. It nevertheless took into account the existence of alternative offers to those of GET to reject the application of the failing company defence.

In its *Provisional Findings Report*, the Competition Commission specifies that it asked the opinion of the Paris Commercial Court as to the most probable alternative scenario, should GET have failed to acquire the SeaFrance assets (§5.9). The court considered it was not permitted to reply to this question. The Competition Commission therefore examined the various options that remained open to the court (to auction off the ships, examination of the two other bids submitted within the deadline, examination of the DFDS bid submitted outside the deadline) and concluded that, whatever decision the court had taken, it was highly likely

that DFDS would have acquired at least two of the ships (the *Rodin* and the *Berlioz*) and operated them on the Calais-Dover route.

The Autorité notes, however, that, in the absence of explanations given by the court, the receiver's report constitutes an essential analytical guide to the credibility of the various scenarios. This report recommended to the court that if a sale were not made to GET, the ships should be auctioned. The other options considered in the Provisional Findings Report are not even mentioned in the representative's report.

Assuming there had been an auction (option 1), the Provisional Findings Report confirms in our view the very hypothetical nature of simulating the behaviour of the other declared or potential bidders and reconstructing the decision that the court would then have taken. As a matter of fact, the conduct of the other declared or potential bidders took into account the fact that GET had publicly announced its intention to submit a bid. It is thus difficult to deduce from this ascertained behaviour how they would have behaved in the absence of an offer from GET and to analyse the bids they would have submitted, even only with regard to the important assessment criterion of the court, which was to maximise proceeds for the creditors. For example, Stena Lines is not mentioned as a potential purchaser of the ships as part of the auctioning process, even though it made an offer to the commercial court that was better than that of DFDS, solely for the purchase of the *Rodin* (€30 million, whereas DFDS's bid was €50 million for both the *Rodin* and the *Berlioz* together, or €30 million for the *Berlioz* alone and €25 million for the *Rodin* alone). If there had been an auction, the withdrawal or absence of GET from the list of potential bidders could also have attracted other bidders who had not previously made themselves known. Nor can we dismiss the possibility that GET itself, through an auctioning process, might have declared itself a candidate for the purchase of the ships alone, rather than a set of assets that could be analysed as an enterprise.

Assuming that the court might have considered the two offers that were in competition with that of GET (option 2), the intention of DFDS to operate the ships under the French flag and on the Calais-Dover route is, according to the *Provisional Findings Report*, an element that would have favoured a decision in support of the DFDS bid (see the footnote 115). The receiver's report -specifies, however, that DFDS had the intention of operating the ships in question on other routes (page 16): "*the other bidders did not specify what flag would be carried, but did indicate that the ships would be assigned to routes other than the original route*". The court's decision could not therefore be based on this comparative advantage. In an

email dated 8 May 2012, DFDS's legal counsel also indicated to us that "*For its part, the DFDS company will also be making an offer for the two ships (Berlioz and Rodin), without there being a plan to assign them to the Calais-Dover route*".

As for the third option which the court could have examined the bid submitted late by DFDS, the Autorité notes that this was not legally permissible.

2. Assessment of the competitive effects of the merger

a) The effect of the operation on the structure of the market: existence of over-capacity in the cross-Channel markets and the exit of DFDS

The Provisional Findings Report initially states that, in view of the growth prospects for market demand, the capacity offered by three operators (P&O, DFDS and GET/MFL) is very much in excess and that these three operators could not stay in the market in a profitable way. The Provisional Findings Report concludes that DFDS was the operator most likely to exit from the market.

The Autorité's decision of 7 November 2012 also noted the existence of significant overcapacity in the cross-Channel freight market, the average rates of overall capacity utilisation by the shipping operators being between 50% and 75% for the period January to June 2012, i.e. a period when the MFL ships were not yet in service. The Autorité did not, however, consider over-capacity to be one of the effects of the operation. On the one hand, such over-capacity largely pre-existed in the business and is explained to a great extent by P&O's investment in larger, new ships and by the decision taken by DFDS to operate two ships on the Calais-Dover route in January 2012 as well as by the GET's acquisition of the SF assets. Furthermore, in the view of the Autorité de la Concurrence, the operation constitutes a merger. Similarly, the acquired assets were assessed by the Competition Commission as constituting an enterprise, since they involved the acquisition not only of ships but of a group of assets that made it possible to enter a market; these assets included the SeaFrance brand and former SF employees (see §6 of the Autorité's decision and 4.1 to 4.62 of the Provisional Findings Report). It does not seem to be consistent with this first part of the analysis to then consider that these same assets constituted new capacities, which GET could bring into the market, rather than the takeover of a company that had previously been present in the market.

It therefore seems to us difficult to present the existence of overcapacity in the cross-Channel freight forwarding market as being one of the effects of the operation.

More specifically, the Provisional Findings Report rejects the possibility of P&O contributing to the reduction in capacity, on the grounds that P&O has just deployed two new high-capacity vessels on the Calais-Dover route. The Provisional Findings Report does not, however, point out that P&O could redeploy some of its ships (*Pride-of-Burgundy*, *Pride-of-Canterbury* or *Pride-of-Kent*) to other routes, as it did with the *Pride-of-Calais*.

The information in the file available to the Autorité de la concurrence, on the basis of which it took its decision of 7 November, did not suggest, despite the statements made by DFDS, that DFDS would soon be abandoning the Calais-Dover route, since it took the decision in January 2012 to launch two new ships (now named the *Delft-Seaways* and the *Deal-Seaways*) on this route after the court decided to reject its first offer to take over the assets of SeaFrance.

At this stage, we find disputable the claims advanced to show that DFDS would be more likely than MFL to leave the market. The Provisional Findings Report considers that the losses and financial strength of GET and DFDS are comparable but that GET has stronger incentives for staying in this market than those of DFDS. However, in the comparison made of the respective financial situations of the two operators, GET's indebtedness may not have been sufficiently taken into account. It is the gross margin (i.e. the EBITDA/Turnover ratios) of each of the two groups that was taken into account to assess their respective capacity to sustain losses. Yet, in view of GET's debt burden (3,761 million euros in 2011 according to the annual report available online), the net margin (net profit and loss/turnover), which takes account of the interest charges on the debt, is the figure that conveys a more relevant picture of the group's financial strength and its capacity to sustain debt. GET's level of indebtedness is so high that associated annual charges "balance with", and even exceeds its operating profits. GET's profit-margin was 1.3% as against 6.3% for DFDS in 2011, and a loss of -7.9% compared with 5.8% for DFDS in 2010. These facts make it impossible to conclude that GET would be capable of withstanding losses, and even lead to the opposite conclusion, particularly since DFDS is a group with a much higher turnover than that of GET (as mentioned in the Provisional Findings Report) and since DFDS is a much more diversified group than GET, as the latter does not operate any other shipping lines.

As to the respective incentives for the two groups to remain in the Calais-Dover route, the Provisional Findings Report points out that GET can no longer leverage its ferry offer on the Tunnel services, due to the commitments it has given to the Autorité. The Provisional Findings Report also points out that DFDS is able to make combined offers (especially for the Dunkirk-Dover and Calais-Dover routes). However, it draws no conclusions as to the incentives for DFDS to leave the market. Yet DFDS is the only operator on the Dunkirk-Dover route and Dunkirk-Dover passenger traffic has experienced a significant increase (+10.7%) since 2007, whereas Calais-Dover is on the decline (-1.9%). On the freight side, Dunkirk-Dover is experiencing less of a drop than Calais-Dover (§7.3 and 7.4 of the Provisional Findings Report).

b) *Unilateral effects*

The connection made between the conclusions summarised above concerning the effect of the operation on the market structures and an analysis of the unilateral effects could be clarify. In fact, it is specified in §8.78 and then in §8.91 of the Provisional Findings Report that an analysis of the unilateral effect is not dependent on the assumption of DFDS's likely exit from the Calais-Dover route, but only on the assumption that MFL would achieve a viable market share. However, the report does not specify how MFL could achieve such a high market share if DFDS continues to have a presence on the Dover-Calais route.

According to the projections submitted by the GET board of directors, MFL's market share could reach 12% for freight and 8% for passenger transport by the end of 2013. These projections are judged by the Provisional Findings Report to be conservative, in view of the market share observed in the past for operators considered to be comparable, namely SeaFrance and DFDS in 2010. At that date, SF had a market share (freight) of 17% and DFDS (the Dunkirk-Dover line) of 14% (table 1 page F4 §8 - Schedule F of the Provisional Findings Report). It is nevertheless debatable whether the market share forecast for MFL could be compared with the SF and DFDS market share in 2010. In fact, in 2010 (a period taken as a reference by the CC) SF was offering a far greater frequency of crossings than MFL is able to provide (SF in 2010: 4 ships and 32 crossings per day, i.e. 16 round trips daily; MFL: three ships of which one is surplus (the *Nord-Pas-de-Calais*) and 16 crossings per day, (i.e. 8 round trips daily)). For its part, DFDS operated 24 crossings, making 12 round trips daily on the Dunkirk-Dover route, using three ships.

That is why the Autorité estimated MFL's freight market share at [5-10]% and its share of passenger transport share at [5-10]% (see table §45 of the decision). With a market share of this size, however, a volume of business for the ferry operators of 63% of total traffic and a pricing ratio¹ equal to 0.81 (§ 87 of the decision), MFL's profit margin would have to exceed [40-50]% if it were to achieve a 5% GUPPI indicator. A profit margin as high as that does not seem realistic to us. Assuming a 12% market share for freight, the GUPPI indicator would reach a threshold of 5% if the MFL margin were greater than 32%. Even with a more realistic margin such as this, it is generally considered² that below 5%, the GUPPI does not show that the operation can lead to unilateral effects.

¹ Price ratio = average price of a ferry crossing/ average price of a crossing via the Tunnel

² Notably: Amelia Fletcher's submission to the Law Society Competition Section Annual Conference (25 May 2011) - "IPR, UPP, GUPPI: An 'alphabet soup' guide to merger assessment"