EUROTUNNEL/SEAFRANCE MERGER INQUIRY REMITTAL

Summary of hearing held with DFDS on 15 April 2014

1. DFDS reiterated its view that Groupe Eurotunnel's (GET's) entry into the Channel ferry market had created a significant overcapacity which, if allowed to continue, would create a substantial lessening of competition (SLC) in the near term. The growth of traffic since 2013, the new MARPOL legislation and DFDS's continued operations on the Dover–Calais route had not affected the original SLC judgment published in the final report of June 2013. It agreed with our provisional findings on the remitted jurisdiction issue.

Impact of economic growth

2. DFDS's two vessels on the Dover–Calais route, along with the introduction of two large P&O vessels (the latest in early 2012) and the entry of GET's (MyFerryLink – MFL) three vessels, had created an unsustainable level of competition. The route had experienced an increased growth rate as additional freight units had been drawn from other surrounding routes. However, this did not translate into a positive impact on profitability. Whilst it and MFL had increased their freight market shares in 2013 – peaking at 26% (including the Dover–Dunkirk service) and 10% respectively – both made losses on the route; DFDS had made a loss of €18 million despite cost cutting and MFL had made a loss of €31 million on top of a loss of €15 million during half a year's operations in 2012. DFDS, like other operators, had benefited from the fact that the freight market in general had grown 4.6% in 2013.

3. On the route in 2013 DFDS made a loss of €[✂] million on earnings before interest and tax (EBIT). It estimated MFL's EBIT loss at around €28 million. DFDS's lower losses were likely to be attributable to it splitting its overheads among more routes as well as the fact that MFL had three vessels on the Dover–Calais route compared with the two DFDS vessels. DFDS forecast a 2014 EBIT loss of €[✂] million for the route with a €[✂] million loss after overheads. Its growth assumptions were [✂]% for freight and [✂]% for passengers.

4. Regarding GET and SCOP's claim that the CC applied growth assumptions had been understated, the 2013 growth had been unusually high due to recovery from the London Olympics when potential passengers had stayed at home. Leaving that aside, DFDS had in any event worked through the figures

on the basis of the growth assumptions put forward by GET and SCOP. DFDS projected that in 2015, the MARPOL legislation would cost it €[✂] million and would cost MFL €[✂] million. This was due to MFL's main two vessels being more fuel efficient. DFDS assumed in its projections that the ferry operators would pass on [✂]% of these costs to customers, although this recovery rate might in fact be optimistic due to overcapacity and its main competitor, the Tunnel, running on electricity and thus not being exposed to increased costs.

5. When analysing GET and SCOP's growth assumptions, DFDS projected that MFL's EBIT loss would decrease to €[✂] million in 2016. MFL's annual report claimed that MFL would break even on EBITDA in 2016, and MFL had originally said that it would break even with an 8% market share. In DFDS's view, MFL's predictions could not be accurate unless MFL attempted to gain significant market shares over the next couple of years. Using the same assumptions, DFDS's EBIT loss would decrease to €[✂] million in 2016. Whilst EBIT levels of both operators would improve according to these assumptions, they would still be at an unsustainable level, and there were also financial costs not shown in the EBITs. Therefore, even applying GET's aggressive market assumptions, the result would be a pre-tax profit status quo.

6. DFDS also presented a scenario based on an assumption that MFL exited the route in 2014 and that its market share would be shared proportionally between the ferry operators and the Tunnel. In this scenario DFDS's growth rate would increase and it would benefit by €[✂] million in 2015 and €[✂] million in 2016. Its MARPOL costs would remain the same. However, as it would have less overcapacity, it would be more likely to be able to recover those costs, together with P&O. This scenario also envisaged a normalisation of prices in 2016, with ferry operators no longer subsidising the consumer. DFDS predicted an EBIT of €[✂] million in 2016 if MFL exited the route during 2014.

Developments in relation to individual operators on the short sea

7. DFDS's continued operations on the Dover–Calais route were not a change of circumstance. [✂] the very clear CMA June 2013 report finding an SLC, and the fact that the report had then been appealed. It had decided to extend its *Molière* vessel charter by a year, at €[✂] per day, as it was waiting for the appeal outcome. DFDS had declined the opportunity to acquire the vessel outright as it could not commit due to the uncertainty of the appeal process. [✂]

8. DFDS was asked to clarify its claim to be losing £[✂] a week on average as a result of MFL's continued operations, given the financial data shared at the hearing, but agreed to provide more information to reconcile the figures. [✂]

9. The Dover–Calais route was not at the heart of DFDS's network of maritime routes (as others had asserted) and, in hindsight, it would not have entered the route in 2012 had it known what would happen subsequently. Its return on invested capital was below its cost of capital, company value was being destroyed in the past two years due to this route, and DFDS's management was under consistent pressure during board discussions and from shareholders about its operations on this route. Growth rates and market shares did not translate financially.

10. DFDS's volumes and utilisation had increased in 2013 but its financial performance remained flat due to the costs of the short-term decisions it had made about vessels and the fact that prices had fallen since 2007. The overcapacity and high fixed costs in the market meant that ferry operators had lowered prices to get a margin of benefit; the ferry operators had been subsidizing customers by around €50 million a year. The lowering of prices had also attracted customers from other nearby routes. DFDS's prices had stabilised in the past year. DFDS claimed that if it was forced to leave the market, MFL and P&O would be able to increase prices to a greater extent than if MFL were to leave the market. Should MFL exit the market, there would still be a price increase, though this scenario would benefit the consumer in the long/medium term as there would still be three operators in the market, rather than two. DFDS did not object to competition – that is why it had a lean cost structure. MFL could potentially come in as a new entrant, entirely separated from GET, as could [✂]. However, DFDS did not believe that this would happen, because no rational competitor with shareholders would behave as GET had done. MFL's losses were only sustained through GET's profits, and GET's plan would ultimately harm consumers.

11. A natural explanation for MFL's losses would be that it had lower prices. MFL had also run campaigns where passengers basically boarded free of charge; neither DFDS nor P&O had offered such promotions. With regard to P&O's declining market share in both passenger and freight, as P&O was the largest operator, the 'race to the bottom' had affected it more, though it had recently regained market share in freight.

12. DFDS believed that customers had tried to remain with it in the lead-up to the Competition Appeal Tribunal's (CAT's) decision anticipating that it would be successful. However, following the outcome, customers had gone to the lowest-priced provider and, as such, its freight market share had decreased since November 2013. GET/MFL had promoted the CAT's decision as a

victory for them which seemed to have influenced the loyalty of DFDS's customers.

13. With regard to the Tunnel's loss of market share in the past 12 months, there had been repair work in the Tunnel which meant less capacity at peak hours, and also the high volume of passengers in the Channel in the summer months meant that some passengers simply had to travel by ferry. DFDS suspected that GET had allocated some traffic to MFL, which meant that some of the Tunnel's freight volume had been pushed to MFL, for example through special offers to drivers as they approached Dover. It was a normal procedure to attract drivers to the next available ferry via SMS text messages or more broad campaigns.

14. The growth of DFDS's Dover–Calais service had, as expected, been to some extent at the expense of its Dover–Dunkirk service, due to the former's higher frequency, and also price levels. It did not believe that the closure of the Ramsgate–Ostend service had significantly affected the Dover–Calais service. The Dover–Calais service had attracted business from a number of other routes and DFDS expected further growth, though the unsustainability of price levels meant that some customers would revert to previously used routes, as the operators of these routes lowered their prices to retain customers. Closures and capacity reductions of several UK–Rotterdam services had benefited the Dover–Calais services.

Impact of new environmental regulations

15. The MARPOL legislation, which would come into effect on 1 January 2015, was not a significant development that had occurred since the publication of the final report. It had been known for a long time that this was coming.

16. DFDS's permitted sulphur content had been reduced to 1% since 2010, in accordance with legislation. It had accommodated the slight increase in bunker costs by passing them on to its freight customers. The industry's main concern going forward was now having to reduce sulphur content to 0.1%. The associated increase in bunker costs or of switching to marine gasoil (MGO) would have a significant impact on bunker costs of around 40 to 50%. The industry had lobbied legislators to help fund the installation of scrubber technology on to vessels and to arrange bilateral exemptions between countries. In March 2012 a UK parliamentary group had issued a report to the effect that the Government was committed to MARPOL, but that as the costs would fall on operators in the ECA areas, the Government should help the industry with abatement technologies.

17. Since June 2012, when MARPOL was implemented in EU law by the IMO legislation, several ferry operators (including DFDS) had invested in retro-fitting their vessels with scrubbers. The shipping lobby had also tried to secure financial support from governments and the EU. The legislation may temporarily lead to growth on the shorter crossings since ferry operators would use more expensive low sulphur fuel until scrubbers or LNG equipment was fitted on vessels on other routes. However, this would not change the economics of the Dover–Calais route. The ferry operators would find it very difficult to recoup the extra fuel cost on that route as their tunnel competitor ran on electricity and so did not face the same challenges. In effect, the new legislation would create a profit windfall for GET's tunnel operations.

18. DFDS installed its first scrubber in 2009 and agreed with its board in 2012 that it would go 'all in' and retro-fit 20 vessels involving a total investment of €100 million. This decision had been made prior to the publication of the final report. The ferry industry had been preparing for the implementation of the new environmental regulations for a number of years and it would temporarily have big effects on the industry until scrubber technology and other adaptations were fully rolled out. The European Commission deployed the European Short-Sea Forum in 2013 to help assist the industry deal with the consequences of the new legislation.

19. By taking the initiative and installing scrubbers early, DFDS would have a period of lower fuel costs than its MGO-fuelled competitors [✂]. Its D-type vessels (operating on Dover–Dunkirk) would not be ready with scrubber technology by 1 January 2015, and there were difficulties in installing the technology on the Dover–Calais route given the current uncertainties, so there would be no immediate competitive advantage on that route. DFDS did not know which ferry operator would be first on the Channel with abatement technology.

20. The Dover–Calais route was unique, as other routes did not have an electric alternative so its competitors faced the same challenges with MARPOL as it did. It said that the potential increase in traffic as a consequence of MARPOL would not represent a windfall for ferry operators on the Dover–Calais route, as the market leader was not affected by the legislation.

21. DFDS had not necessarily agreed with the conclusions of the 2013 AMEC report, which suggested that ferry operators would choose MGO over installing scrubbers, as there was not enough time to install the new technology, and this technology was still at an early stage of development. The industry presented this 'nightmare' situation in order to gain financial support or postponement. The scrubber technology worked, but not for every single vessel; DFDS estimated that scrubbers would work on 40% of its

vessels. Several other operators were also prepared to invest in scrubber technology.

22. Scrubber installation costs were typically €6 million per vessel and were better suited to RoRo vessels than RoPax vessels because RoRo vessels had fewer engines and higher deadweight capacity. There was a two-and-a-half to three-year payback on scrubbers. Alternatively, LNG conversion would be at least €12 million per vessel though many new builds were LNG; DFDS was currently considering its LNG options. P&O was intending to use a combination of scrubbers and MGO, whilst Brittany Ferries, which might be aided by French government subsidies, was intending to combine scrubbers and LNG.

23. The increased need for MGO and pressure on refining capacity would not lead to increased diesel costs. DFDS went to bunker suppliers in Denmark and the introduction of low sulphur into the ECA areas was not expected to affect diesel prices. If MGO was unavailable here, then it would be imported from other places such as Asia; this would only be an issue when the rest of the world fleet in 2020 or 2025 will start needing the product.

24. DFDS agreed that the effect of MARPOL would be an initial strengthening of demand for the Dover–Calais route, but after 18 months it considered that the impact would be nullified as ships on competing routes were equipped with scrubbers.

Remedies

25. With regard to the implementation of remedies, DFDS urged us to reduce the implementation time to the shortest possible period as a stretched-out process benefited GET. It would lead to the ferry operators being weaker competitors to the Tunnel due to the losses incurred in 2012, 2013 and potentially 2014. GET would also benefit from the increased fuel costs for ferry operators in 2015.

26. Since the final report, DFDS considered that the implementation time for GET to divest the *Berlioz* and the *Rodin* vessels should be reduced from six months to three months given the amount of time the investigation had already taken and the amount of damage that had been inflicted on the ferry operators. Whilst DFDS accepted that MFL could still operate for the summer months, GET had deliberately stalled for time and had in fact been interested in tendering for the Dieppe–Newhaven route. DFDS thought GET did not want DFDS to be in a position to acquire the potentially divested vessels.

27. MFL's customers would not be affected by a short divestment period, as the contracts were inter-operational, meaning that the remaining operators could absorb these customers.

28. The structural remedy was the only way to resolve the SLC. Behavioural remedies were seen as weak. GET had very clear intentions from the outset; in addition, GET had supported MFL by any means available despite the remedies implemented in France.