

Anticipated acquisition by Greater Manchester Buses (South) Limited, a wholly owned subsidiary of Stagecoach plc, of Bluebird Bus & Coach

ME/5827/12

The OFT's decision on reference under section 33(1) given on 22 February 2013. Full text of decision published 27 February 2013.

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Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

## PARTIES

1. Greater Manchester Buses (South) Limited (**Stagecoach**) is the Manchester bus operating unit of Stagecoach Group. Stagecoach employs 1,922 people and runs a fleet of 646 buses from four depots in the Manchester area, operating a mix of commercial and tendered bus services. Stagecoach had a turnover of approximately £97 million for the financial year ending 30 April 2012. The majority of Stagecoach's relevant bus services are in the South of Manchester.
2. Bluebird Bus & Coach (**Bluebird**) is an independent, privately-owned operator of commercial and tendered bus services in Manchester. Bluebird employs 84 personnel and operates a fleet of 45 vehicles. Bluebird's turnover for the year ending 31 January 2012 was approximately £4 million. The majority of Bluebird's bus services are in the North East of Manchester.

## TRANSACTION

3. The parties entered into an asset purchase agreement on 6 November 2012, in which Stagecoach agreed to pay £2.05 million (subject to adjustments) in consideration for a collection of Bluebird's assets (the **Transaction**). The assets which Stagecoach will acquire as part of the Transaction are services, vehicles, employees (under a TUPE transfer) and a small depot located in Middleton, Manchester.

4. The Transaction is conditional upon a decision by the Office of Fair Trading (**OFT**) that it does not intend to refer the Transaction, or any part of it, to the Competition Commission (**CC**).
5. The Transaction was notified to the OFT on 4 December 2012 and the administrative deadline was 15 February 2013.

## **JURISDICTION**

6. As a consequence of the Transaction, Stagecoach and Bluebird will cease to be distinct. The OFT believes that the combination of assets acquired by Stagecoach is sufficient to constitute an 'enterprise' for the purposes of section 23 of the Enterprise Act 2002 (the **Act**).
7. The parties overlap in the supply of commercial and tendered local bus services in the Greater Manchester area. In 2011, Stagecoach's share of supply was approximately 31 per cent and Bluebird's share of supply was approximately two per cent. As such, the OFT considers that the share of supply test in section 23(4) of the Act is met.
8. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **COUNTERFACTUAL**

9. Stagecoach submitted that the appropriate counterfactual against which to assess whether the Transaction creates a realistic prospect of a substantial lessening of competition (**SLC**) may not be the prevailing conditions of competition. Stagecoach submitted that Bluebird had recently encountered difficulties maintaining the operation of its bus services. It also submitted that Bluebird was experiencing solvency issues and may exit the market in the coming months.
10. In order for the OFT to accept an exiting firm argument, it would need (on the basis of compelling and verifiable evidence) to believe that it was inevitable that the firm would exit the market, be confident that

there was no substantially less anti-competitive purchaser for the firm or its assets and, similarly, be satisfied that if the firm did exit a sufficient proportion of its sales would have diverted to the acquirer firm.<sup>1</sup>

11. Although the OFT did receive some evidence that Bluebird was experiencing financial difficulties, the evidence related only to difficulties which had arisen following the announcement of the Transaction. The OFT did not receive any evidence that Bluebird had been experiencing financial difficulties prior to such announcement. As such, the OFT believes that it has not been provided with sufficient evidence that Bluebird would have inevitably exited the market in the absence of the Transaction.
12. Accordingly, the OFT did not consider it appropriate to depart from its usual practice of adopting the prevailing competition conditions as the counterfactual in this case.

## **FRAME OF REFERENCE**

13. The parties overlap in the provision of tendered and commercial local bus services in the Greater Manchester area.

### **Product Scope**

#### **Competition for tendered contracts**

14. Stagecoach submitted that there are separate markets for the provision of commercial bus services and the right to operate tendered services. This is consistent with previous OFT and CC decisional practice.<sup>2</sup> It is also consistent with the CC's local bus market report which concluded that the competition for the tendering of supported services should be analysed separately from the provision of local bus

<sup>1</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.10.

<sup>2</sup> Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland, OFT decision, 21 January 2013 and Anticipated acquisition by Arriva Northumbria Limited of the bus operations of Go North East Limited in Ashington, Northumberland, OFT decision, 11 February 2010.

services, while taking into account that there may be some linkages between commercial and tendered services.<sup>3</sup>

15. Based on the evidence available, the OFT considers that this framework for the analysis is appropriate in this case, and has assessed the Transaction on the basis of separate frames of reference for competition for tendered contracts and the provision of commercial bus services.

#### Commercial and tendered bus services

16. As noted above, the OFT considers that there are separate frames of reference for competition for tendered contracts and the provision of commercial bus services. However, once tendered, in some circumstances, a tendered service may overlap or compete with a commercial service. In relation to this aspect of bus competition, Stagecoach submitted that tendered services do not compete with commercial services. The OFT notes that this position is not consistent with the CC's findings in its local bus market report where it found that, for passengers, tendered bus operations provide a service in the same way as they would for a commercial route.<sup>4</sup> The OFT has also previously noted that competition may occur between overlapping commercial and tendered services.<sup>5</sup>
17. The OFT considers that overlapping commercial and tendered services can, absent evidence to the contrary, compete from the demand-side perspective of end users. In this case, the OFT observes that Transport for Greater Manchester (**TFGM**)<sup>6</sup> typically tenders local bus

<sup>3</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 7.120.

<sup>4</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 7.114.

<sup>5</sup> Anticipated acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, OFT decision, 10 July 2012 and Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland, OFT decision, 21 January 2013.

<sup>6</sup> Transport for Greater Manchester is the relevant local authority responsible for implementing local transport policy and supporting bus services that would not be provided on a purely commercial basis in Greater Manchester.

services on a net subsidy basis, which means that operators are encouraged to grow passenger revenue. TFGM does not specify the fare structure tender operators must charge, but does monitor certain quality parameters. Accordingly, the OFT considered that a merger involving overlapping commercial and tendered services may, under these circumstances, lead to a loss of competition (since the structure of the contracts incentivises the tendered operator to compete with the commercial service provider).

18. Therefore, on a cautious basis, the OFT considered that the frame of reference for the provision of bus services should include both commercial services and overlapping tendered services.

#### Other forms of transport

19. In its recent local bus market report, the CC concluded that other forms of transport did not form part of the same product market as bus travel.<sup>7</sup> However, the CC did find that competition from other forms of transport may provide an effective competitive constraint.
20. Stagecoach submitted that both mainline rail and light rail travel act as a constraint on bus travel in Greater Manchester in respect of certain overlap flows in this case. Stagecoach also argued that the potential for passengers to switch some or all of their demand from bus journeys to car, cycle or foot journeys provides an important constraint on the price and quality of service which can be set by a bus operator, particularly in a metropolitan area where journeys are likely to be comparatively short. Stagecoach did not provide the OFT with evidence to support this claim.
21. Accordingly, the OFT did not include other forms of transport in its product frame of reference in this case. However, in line with the CC's approach in its local bus market investigation, the OFT considered the extent to which rail and light rail travel acts as a constraint on relevant overlap flows.

<sup>7</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 7.64.

## **Geographic Scope**

### **Competition for tender contracts**

22. The OFT considers the geographic frame of reference for tenders to be sub-national, based on the region where the tenders are offered.<sup>8</sup> This is consistent with the CC's local bus market report<sup>9</sup> which found that the market for tenders will generally include all bus operators in the local area. The OFT has therefore assessed competition for tenders in the Greater Manchester area.

### **Commercial and tendered bus services**

#### **Flow level**

23. Stagecoach submitted that the relevant geographic markets in this case are a series of overlap flows in the Greater Manchester area. In line with previous cases, the OFT assessed the impact of the Transaction on a flow-by-flow basis, where a 'flow' is defined as a connection between two specific points. This approach has been taken because passenger demand is for travel between two points. In line with previous decisional practice, flows which have both their origin and destination within 500 metres of each other are likely to be demand-side substitutes, subject to the services having a sufficiently similar level of frequency and frequency distribution over time.<sup>10</sup>

#### **Network level**

24. Consistent with previous cases,<sup>11</sup> the OFT considers it may be appropriate to assess the impact of the merger at a network level in

<sup>8</sup> Anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited, OFT decision, 23 December 2009 and Anticipated acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, OFT decision, 10 July 2012.

<sup>9</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 7.119.

<sup>10</sup> CC Report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009.

<sup>11</sup> Acquisition by McGill's Bus Services Limited of the Arriva Scotland West local bus business, OFT decision, 18 April 2012 and Anticipated acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, OFT decision, 10 July 2012.

addition to competition on specific point-to-point flows.

25. As regards demand-side considerations, Stagecoach submitted that the parties' networks are complementary and that passengers are unlikely to use the parties' services to make multi-journey trips across their networks. However, supply-side considerations can also make it necessary to assess competition at the network level. This is especially relevant where potential entry/expansion from one party may exert a significant competitive constraint on the other party on non-overlap flows.
26. Accordingly, the OFT has not excluded the prospect that some competition occurs at a network level. The OFT considered that the area of Greater Manchester is the most appropriate focus for the current investigation.

#### Conclusion on frame of reference

27. In summary, the OFT has analysed the transaction in relation to the following frames of reference:
  - i. the supply of local bus services (both commercial and tendered) on relevant overlap flows
  - ii. the supply of local bus services at a network level in the Greater Manchester area, and
  - iii. the market for tendered bus services in the Greater Manchester area.

## HORIZONTAL ISSUES

28. The parties overlap in the provision of local bus services on a number of flows in the Greater Manchester area.
29. The OFT considered whether the Transaction was likely to result in a SLC with respect to:
  - i. actual competition on overlap flows
  - ii. actual competition for tendered services
  - iii. actual competition at a network level, and

- iv. Potential competition at a network level.

#### Actual competition on overlap flows

- 30. In this case, as of April 2013,<sup>12</sup> the parties' services will overlap on 31 passenger flows. In order to focus the analysis on those areas that are most likely to give rise to competition concerns, in line with decisional practice, the OFT applied certain filtering methodology to screen out flows that are unlikely to raise concerns. A description of the applicable filters follows:
  - i. **the relative importance of overlapping flows:** we have excluded those routes for which overlaps account for less than 10 per cent of passengers and revenue<sup>13</sup>
  - ii. **countervailing competition:** we have excluded flows that are the subject of effective countervailing competition from third parties. The appropriate definition of an effective competitor differs depending on the geographic characteristics of the flows or routes,<sup>14</sup> and
  - iii. **de minimis:** we have excluded flows of relatively little importance, in terms of either revenue, number of passengers or frequency of service.<sup>15</sup>
- 31. The OFT's analysis, based on evidence supplied by the parties, indicates that 30 of the 31 overlapping flows can be filtered out on the basis of one or more of the above filters. The OFT found, however, that the flow comprising the overlap of Bluebird's service 77 and Stagecoach's service 76 from Manchester (Bradford Road) to Briscoe Lane/Newton Heath (the **Overlap Flow**) should be assessed in more detail.

<sup>12</sup> TFGM re-tendered a number of supported services in January 2013 to commence in April 2013.

<sup>13</sup> CC, Review of methodologies in transport enquiries, 2006, paragraphs 26.

<sup>14</sup> The CC has suggested frequency filters to indicate whether a bus operator's services are likely to constitute an effective competitive constraint. See CC Report, Completed acquisition by Stagecoach Group Plc of Eastbourne Buses Limited and Cavendish Motor Services Limited, October 2009, Appendix I.

<sup>15</sup> CC, Review of methodologies in transport enquiries, 2006, paragraphs 25 to 29.



32. In terms of the key characteristics on the Overlap Flow:

- i. both services are commercial, except at certain times (early-morning and late-evening when Bluebird runs a tendered service 77, that is supported by TFGM)
- ii. the flow is 4.9 kilometres in length
- iii. both services originate in Manchester city centre and travel along the Oldham Road, turning off down Butler Street before heading along Bradford Road and Briscoe Lane to Newton Heath<sup>16</sup>
- iv. the termination of the service differs with the Stagecoach service terminating in Oldham, and the Bluebird service mostly terminating in Newton Heath<sup>17</sup>
- v. Stagecoach service 76 runs six buses an hour in peak times while Bluebird runs three buses an hour
- vi. the revenues achieved on the Overlap Flow are approximately £[ ] (Bluebird service 77) and £[ ] (Stagecoach service 76) with combined revenue on the overlap flow of £[less than 400,000].<sup>18</sup>

33. The parties are the only operators of local bus services on the Overlap Flow.<sup>19</sup> Accordingly, the Transaction constitutes a merger to monopoly on the Overlap Flow and the OFT considers that, prima facie, a SLC can be expected to result from the Transaction. The OFT therefore looked at whether there are factors in this case which might mitigate against a finding of a SLC. Specifically, the OFT was provided with the following key evidence in respect of its examination of whether the Transaction will result in increased prices or reduced frequencies to the detriment of consumers.

34. Given that both parties' multi-journey tickets apply to the whole of their network, the OFT considers that price rises are more plausible for customers using single trip tickets, rather than multi-journey tickets.

<sup>16</sup> The parties diverge at the junction with Scotland Hall road, but subsequently join again at Daisy Bank.

<sup>17</sup> Bluebird's 77 service terminates in Moston early-morning and late-evening, mostly during the times at which it is supported by TFGM.

<sup>18</sup> In addition, TFGM told the OFT that the value of the tender contract is £3,911 per annum, although this would apply to the entire service and not just the overlap flow.

<sup>19</sup> The parties will continue to be the only operators between these two points after April 2013.

Price rises on multi-journey tickets are likely to be further limited due to the multi-operator tickets (System One), which allow passengers to travel on any operator's services in Greater Manchester.

35. The evidence indicates that the proportion of passengers using single trip tickets on Stagecoach's Service 76 is approximately [ ] per cent and for Bluebird's Service 77 it is approximately [ ] per cent. The OFT considers that there remains an incentive to raise prices on single trip tickets as these represent a substantial proportion of the tickets on the Overlap Flow, especially with respect to the Bluebird service.
36. However, Stagecoach submitted that this incentive does not exist and, in addition to the fact that price rises on multi-journey tickets are likely to be limited, it has, in effect, a self-imposed cap on single fares due to the fact that it applies a standard fare scale across Greater Manchester. This fare, it submitted, does not vary in accordance with the presence or otherwise of a competitor on a given route or flow. The evidence available to the OFT did not support this contention. The OFT observed that Stagecoach does deviate from this fare scale on occasion, and therefore it remains concerned that there would be an incentive to raise single fares post-Transaction on the Overlap Flow.
37. In addition to price, the OFT also considered the impact of the Transaction on other factors of service delivery which are often impacted by competition, such as, the frequency of services on the Overlap Flow. As set out above, Stagecoach service 76 currently runs six buses an hour in peak times and Bluebird service 77 currently runs three buses per hour. Stagecoach provided the OFT with an internal document in which its plans for Services 76/77 were discussed. The options set out are either operating the two services using one less vehicle or retaining the current frequency of Service 76, but increasing the frequency of Service 77. Stagecoach argued that even if the first option were chosen, then the buses would be run as an integrated and more evenly spaced service, which would be of benefit to passengers.
38. The OFT notes that the Transaction would provide Stagecoach with an opportunity to change the frequency of bus services and that this could lead to a detriment to passengers. The OFT accepts that Stagecoach's plans may lead to a more sensible approach to service frequency but it has not been possible to ascertain from passengers

the extent to which service harmonisation would benefit them. The OFT also notes that Stagecoach could change this approach at any time and would not face any competition when making such changes. As such, the OFT has found that the evidence provided to it indicates that there is a realistic prospect of the merged entity reducing the frequency of service on the Overlap Flow following the Transaction to the detriment of passengers.

39. Nevertheless, the parties submitted that there are a number of mitigating circumstances in this case which act against a SLC arising from the Transaction. These are the nearby presence of First, the availability of Metrolink as an alternative to buses and the immateriality of the Overlap Flow. Each are discussed below.

#### First services along the Oldham Road

40. Stagecoach submitted that the overlap does not give rise to competition concerns on the basis that passengers could avail themselves of First services which operate on the parallel Oldham Road for at least part of the Overlap Flow. Stagecoach accepted that the parallel stops along the Oldham Road are not within the same geographic market as the stops along the Overlap Flow (because they are further than 500 metres away). However, it provided the OFT with evidence that almost all of the bus stops along the Oldham Road are within 1000 metres of the Overlap Flow. Stagecoach referred to the CC's analysis in *Stagecoach/Preston* in which the CC noted that, where two bus stops were more than 1000 metres apart, there will be negligible competitive interaction between them.<sup>20</sup>
41. Accordingly, Stagecoach submitted that, where bus stops are located within 1000 metres of each other, there will be some competitive interaction. For passengers whose origin or destination is located between the Oldham Road and the Overlap Flow, Stagecoach submitted that the First services along the Oldham Road provide a constraint.
42. The OFT considered whether passengers might consider the First services operating along the Oldham Road as a suitable alternative to

<sup>20</sup> CC Report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009, Appendix I, paragraph 9.

the parties' services. The area between the Oldham Road and the Overlap Flow is partly residential, and partly industrial. The OFT considers that it has not been provided with sufficiently compelling evidence that passengers in that area would consider the First services along the Oldham Road to be a suitable alternative.

#### Metrolink

43. Stagecoach also submitted that the Metrolink tram could offer passengers travelling between Manchester city centre and Newton Heath an alternative. The Metrolink tram stop at Newton Heath is located within 600 metres of Briscoe Lane/Old Church Street junction toward the end of the Overlap Flow. The tram runs every 12 minutes throughout the day and runs slightly North of the Oldham Road to Manchester city centre.<sup>21</sup> Given that the Metrolink service was only launched in 2012, the parties have not provided any evidence of the impact of this on its service 76.

#### Materiality of the overlap flow

44. For Stagecoach, the revenue from the Overlap Flow amounts to approximately [less than 25] per cent of the revenue for the entire route (Manchester to Oldham). The OFT has therefore considered whether this is material enough to affect decision-making by Stagecoach in respect of the competitive parameters on this route.
45. Stagecoach provided the OFT with internal documents demonstrating the significance of Service 77 to the commercial rationale for the Transaction. Most of the synergies anticipated are derived from merging services 76 and 77 and removing a bus from the route. Furthermore, the OFT notes that except early-morning and late-evening, the Overlap Flow makes up the vast majority of Bluebird's service 77. Therefore, the evidence indicates that the Overlap Flow is material with regard to the overall routes.

<sup>21</sup> The Metrolink tram stop in Manchester City Centre (Market Street) is less than 200 metres from the Service 76 and 77 terminus (Manchester Piccadilly).

## Conclusion on actual competition on Overlap Flow

46. The Transaction is a merger to monopoly on the Overlap Flow. The OFT accepts that there may be some constraints on Stagecoach's behaviour after the Transaction, such as nearby transport alternatives, the threat of potential competition and limitations on the ability to change multi-ticket prices. However, the OFT considers that it has not received compelling evidence in relation to those constraints to be able to dismiss its concerns relating to the impact of the Transaction on prices, especially single trip fares, and frequencies.
47. In light of the above, the OFT considers that the Transaction gives rise to a realistic prospect of an SLC on the Overlap Flow in the form of increased prices or reduced frequencies.

## Actual competition for tendered services

48. Stagecoach submitted that the Transaction would not have an impact on competition for tendered services given the large number of actual and potential competitors for tender awards. It told the OFT that in the most recent 12 months of tender awards, there were on average over seven bids per contract.
49. The OFT received data from TFGM relating to all tender awards since 2010. This data indicated that there is no particular geographic concentration of tender competition between the parties. Both parties bid for tenders outside their typical commercial operating area (Stagecoach in the South and Bluebird in the North East). There were no tenders for which Stagecoach and Bluebird were the only bidders.
50. TFGM further noted that there are currently 32 bus operators registered on its tender award system and that it had no concerns relating to the impact of the Transaction on tendered services. TFGM operates a supplier rating system under which Bluebird is rated as 'poor'. TFGM therefore told the OFT that it anticipated that the acquisition would deliver positive improvements to quality on those services which are affected, to the benefit of passengers.
51. In light of the above, the OFT does not believe that the Transaction gives rise to a realistic prospect of a SLC in relation to actual competition for tendered services.

#### Actual competition at a network level

52. Stagecoach submitted that, while both parties operate services which could be viewed as networks, competition between the parties at the network level does not exist. Stagecoach's core commercial operating area is in the South of Manchester while Bluebird's core commercial operating area is in the North East of Manchester. Each party operates limited services outside its respective core commercial operating area. Accordingly, Stagecoach submitted that there are relatively few passengers who are likely to consider the parties' networks as suitable alternatives for journeys involving multiple services.
53. Stagecoach informed the OFT that, as a result of its acquisition of Universal Bus Limited in 2002, it operated a depot in Chadderton which is located in the North East of Manchester. This depot mainly serviced local tendered services and at one point housed a commercial service from Manchester to Rochdale which Stagecoach no longer operates. However, in 2007, it decided not to renew the lease.
54. Furthermore, a multi-operator ticket scheme exists in the Greater Manchester area in which participation is, in effect, a mandatory requirement for local bus service operators. The multi-operator weekly ticket is more expensive than the Stagecoach weekly ticket. While the OFT was informed that the multi-operator ticket is more important to Bluebird's finances than to Stagecoach's, the OFT considers it unlikely that the Transaction would materially affect the ability or incentive for Stagecoach to increase the cost of the multi-operator ticket to make its own appear more attractive.
55. On the basis of the evidence presented to the OFT, it does not believe that the Transaction gives rise to a realistic prospect of a SLC in relation to actual competition at a network level.

#### Potential competition at a network level

56. A SLC may not only result from a loss of actual competition, but also from a loss of potential competition.<sup>22</sup> With regard to this, the OFT has given careful consideration to whether the threat of expansion by

<sup>22</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.4.13.

either party has had a material effect on the strategy and competitive reactions of the other.

57. The OFT considered the extent of the constraint imposed on Stagecoach by the threat of expansion by Bluebird in the South of Manchester. The parties submitted that Bluebird has only previously operated tendered services outside of North East Manchester. Bluebird told the OFT that this is due to the location of its depot, which is in Middleton. It would be unlikely to find it commercially viable to launch commercial services in South Manchester due to the potential 'dead mileage'<sup>23</sup> involved in sustaining such services. The OFT did not find any evidence that Bluebird had planned to enter routes in the South of Manchester. Nor did it find any evidence that Stagecoach had set its pricing and timetabling in fear that Bluebird would enter.
58. The OFT also considered the extent of the constraint imposed on Bluebird by the threat of expansion by Stagecoach in the North East of Manchester. Stagecoach informed the OFT that it has not previously considered operating more actively in the North of Manchester due to the presence of First.<sup>24</sup> Historically, in the Greater Manchester area, Stagecoach's core area of operation has been the South and First's core area of operation has been the North.<sup>25</sup> Stagecoach submitted to the OFT that First has not left any commercial gaps in its services.
59. Furthermore, Stagecoach submitted that the traffic management policies and congestion in Manchester mean that it is commercially unattractive to operate services which are located far away from its depots, which are mainly in the South of Manchester.
60. The OFT noted that Stagecoach operates two depots which are located in the East of Manchester, which could potentially be used to

<sup>23</sup> Dead mileage refers to the sunk cost of getting the buses to the correct starting point for the service, or the costs involved during driver changeovers.

<sup>24</sup> The bus services in the Greater Manchester area were split into two prior to privatisation, upon which the North was acquired by First and the South was acquired by Stagecoach.

<sup>25</sup> This is in line with the CC's conclusion in its report on the local bus market which found that bus operators rarely engage in head-to-head competition and this reduces the competitive constraint from potential competition. Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 2.

launch further commercial services in the North. Furthermore, Stagecoach previously operated a depot in Chadderton which is located in the North East of Manchester, in the heart of Bluebird's core commercial operating area. However, Stagecoach submitted that its depot in Ardwick, which is located nearest to Bluebird's core commercial operating area, is operating [ ]. Stagecoach also highlighted its decision to cease operating the depot in Chadderton as evidence that it has not considered attempting organic growth in North Manchester.

61. Bluebird submitted that the actual competition it faces from First and JP Travel in its core area is a far more important constraint than any potential competition from Stagecoach. It told the OFT that it sets its fares based primarily on its own cost base, but with consideration of other operators in the area such as First and JP Travel. Although the OFT has not been provided with any evidence of this, the OFT accepts that, while the threat of further expansion from Stagecoach in North Manchester may impose a limited constraint on Bluebird, it is likely that the actual competition it faces from First and JP Travel is a greater constraint, and will continue to be a significant constraint following the Transaction.
62. Overall, the evidence indicates that the parties were not materially constrained by the potential entry of the other party in their respective core commercial areas. In Bluebird's case, it was more focused on competitors within its core commercial area rather than on competitors from outside it. Accordingly, the OFT does not believe that the Transaction gives rise to a realistic prospect of a SLC in relation to potential competition at a network level.

### **Barriers to entry and expansion**

63. The OFT discussed the possibility of entry in relation to the Overlap Flow on which it has found a realistic prospect of a SLC above. However, in addition to this, the OFT notes that the CC report on the local bus market identified a number of barriers to entry and expansion into the supply of local bus services. These include the fact that it often takes time for operators to build up new routes in competition with an existing operator and that they may incur losses on routes



while they do so.<sup>26</sup> Furthermore, and most relevant to the current Transaction, the CC found that fear of strategic retaliation from the incumbent can create a barrier to entry.<sup>27</sup>

64. In this case, Stagecoach submitted that it will be constrained on the Overlap Flow between Bradford Road and Briscoe Lane/Newton Heath by potential competition. Stagecoach argued that Both First and JP Travel are likely potential competitors, and they both operate depots close to the Overlap Flow. As evidence of JP Travel's likelihood of entry, Stagecoach pointed to the fact that it recently registered a new service 112 over the existing Bluebird 112 route every 20 minutes between Middleton and Manchester via Moston.
65. Although the OFT considered whether Stagecoach would be constrained by potential competition from other operators, it noted the CC's conclusion in its local bus market report that bus operators are unlikely to engage in head-to-head competition unless there are gaps in service provision.<sup>28</sup> [ ]. The parties were unable to submit any evidence to a compelling standard that either First or JP Travel are likely to enter against the merged entity on the Overlap Flow in a timely and sufficient manner.
66. Accordingly, the OFT does not consider entry or expansion would be sufficiently timely and likely to mitigate its concerns.

### **THIRD PARTY VIEWS**

67. The majority of third parties, including passenger groups, indicated that the Transaction might increase competition in the Greater Manchester area with Stagecoach competing more effectively with

<sup>26</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 9.16.

<sup>27</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 9.65.

<sup>28</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 2.

First. One third party pointed to the beneficial impact of the Transaction in terms of service quality and reliability.

68. One third party expressed concerns that [ ]. However, the OFT notes that this was claimed to be due to [ ].
69. The OFT's investigation into the Transaction and invitation to comment were highlighted in an article in the Middleton Gazette. However, the OFT received no concerns as a result.

## **ASSESSMENT**

70. As a result of the Transaction, Stagecoach and Bluebird will cease to be distinct. The share of supply test is met as the merging parties overlap in the supply of local bus services in the Greater Manchester area, where Stagecoach's share of supply is approximately 31 per cent and Bluebird's share of supply is approximately two per cent. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created pursuant to section 23 of the Act.
71. The OFT considered whether it was appropriate in this case to depart from its usual practice of adopting the prevailing competition conditions as the counterfactual. However, it was of the view that it did not receive sufficiently compelling evidence to do so.
72. The OFT considers that the relevant frames of reference in this case were the supply of local bus services (both commercial and tendered) on relevant overlap flows and at a network level in the Greater Manchester area, and the market for tendered bus services in the Greater Manchester area.
73. As of April 2013, the parties will overlap on 31 flows in Greater Manchester. Having applied the filters developed by the CC for bus mergers, the OFT found that there was one flow which gave rise to unilateral effects concerns (from Bradford Road to Briscoe Lane/Newton Heath). The parties are the only operators of local bus services on this Overlap Flow. The OFT has not been provided with sufficient evidence to indicate that there is a sufficient constraint on

this Overlap Flow to prevent competition concerns from arising, in particular in relation to increased prices or reduced frequencies.

74. With respect to actual competition for tendered services, the OFT did not identify any concerns due to the large number of actual and potential competitors for tender awards. With respect to actual and potential competition at a network level, the OFT did not identify any concerns due to the limited overlap in the parties' respective networks and the fact that the parties were not materially constrained by the potential entry of the other party in their respective core commercial areas.
75. Third parties were mostly supportive of the Transaction. However, taking into consideration that the Transaction results in a merger to monopoly on the Overlap Flow, and the fact that barriers to entry in the bus market have previously been found by the CC to be high, the OFT's concerns relating to price increases and frequency reductions on the Overlap Flow could not be dismissed.
76. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **EXCEPTIONS TO THE DUTY TO REFER**

77. Where the OFT's duty to refer is engaged, the OFT may choose not to refer the merger under investigation to the CC on the basis of a number of exceptions to the duty. These exceptions include the relevant customer benefits exception pursuant to section 33(2)(c) of the Act and the markets of insufficient importance (or de minimis) exception pursuant to section 33(2)(a) of the Act. Each is considered below.

### **Relevant customer benefits**

78. Stagecoach submitted that the Transaction would result in significant customer benefits as a result of:

- i. Stagecoach's lower fares and increased quality and reliability of service as compared with Bluebird<sup>29</sup>
  - ii. The benefit to passengers of extending the area over which they can use multi-journey tickets
  - iii. The response by First to reduce fares as a result of the Transaction, and
  - iv. An increased competitive environment.
79. As outlined in the OFT guidance on exceptions to the duty to refer (**Exceptions Guidance**), in order for the OFT to consider exercising its discretion, the claimed relevant customer benefits must be clear, and the evidence in support of them must be compelling and merger-specific.<sup>30</sup> However, the OFT currently considers that the parties have not provided sufficiently compelling and verifiable evidence for the claimed relevant customer benefits. Although the OFT accepts that First has reduced its fares on services within the M60 ring-road, it was informed by First that this was not in response to announcement of the Transaction. The OFT has therefore not received enough evidence to suggest that this reduction in prices was merger-specific.
80. Therefore, on the evidence available to it, the OFT does not currently consider it appropriate to exercise its discretion not to refer the Transaction on the basis of customer benefits.

#### Markets of insufficient importance

81. The OFT has the discretion, pursuant to section 33(2)(a) of the Act, not to make a reference to the CC if it believes that the market(s) concerned is/are not of sufficient importance to justify a reference. In considering whether to apply the de minimis exception, the OFT will consider, in broad terms, whether the benefit of a reference in terms of the potential customer harm saved is materially greater than the cost of a CC reference (being around £400,000).<sup>31</sup>

<sup>29</sup> Stagecoach's fares are currently lower than Bluebird's, it is ranked second across all operators by TFGM for operators of tendered services, and its environmental credentials have been recognised with various awards.

<sup>30</sup> Exceptions Guidance, paragraph 4.9.

<sup>31</sup> Exceptions Guidance, paragraph 2.11.

82. Given that the annual value of the affected market in this case is less than £10 million (see paragraph 87 below), the OFT has considered whether it should apply the de minimis exception.<sup>32</sup>
83. The OFT's general policy, regardless of the size of the affected market, is not to apply the de minimis discretion exception where clear-cut undertakings in lieu of a reference could be offered by the parties to resolve the concerns identified.<sup>33</sup>
84. In most cases, a clear-cut undertaking in lieu will involve a structural divestment. As such, the OFT considered whether the parties could have divested either of the parties' routes involving the Overlap Flow. However, as set out above, Stagecoach's internal documents indicate that the acquisition of Bluebird's route 77 underlies the key rationale for this Transaction because most of the anticipated synergies would be derived from merging services 76 and 77. The OFT is therefore of the view that the divestment of either route 76 or 77 would be tantamount to reversing the Transaction. The OFT does not include what would amount to a prohibition of the merger when considering whether an 'in principle' undertaking in lieu is available.
85. Accordingly, the OFT did not consider that an 'in principle' clear-cut undertaking in lieu was available in this case.

#### Relevant factors

86. As outlined in the OFT's Exceptions Guidance, the OFT will consider the level of consumer harm by reference to a number factors when deciding whether or not to apply the de minimis exception: the size of the market, the likelihood that the SLC will actually occur, the magnitude of competition that would be lost by the merger, and the duration of the SLC.<sup>34</sup> Each is considered in turn below.

#### Market size

87. As set out above, the OFT has concluded that the Transaction gives rise to a realistic prospect of a SLC affecting a market worth an estimated £[less than 400,000]. The parties submitted that this figure

<sup>32</sup> Exceptions Guidance, paragraph 2.14.

<sup>33</sup> Exceptions Guidance, paragraph 2.2.

<sup>34</sup> Exceptions Guidance, paragraph 2.12.

overstates the revenue achieved by the parties as it does not relate to the exact overlap flow in question. The parties submitted that if the appropriate deductions are made, the revenue would amount to approximately £[less than 300,000]. However, given that the robustness of the data provided by the parties is unclear, on a cautious basis, the OFT considers the market size in this case to be approximately £[less than 400,000].

88. In any event, this market size is well below the £10 million threshold above which de minimis exception will not be applicable. It is also significantly below £3 million for which a reference to the CC would generally not be justified.<sup>35</sup> However, as discussed further below, the OFT might not apply the £3 million threshold where there are wider implications of any decision such as replicability.<sup>36</sup> Furthermore, the OFT also notes the recommendation from the CC in its local bus market report to consider a lower market size threshold than £3 million for bus mergers.<sup>37</sup>

### **Likelihood of harm**

89. Stagecoach submitted that the likelihood of a SLC arising and harm resulting from this Transaction is firmly at the lower end of the scale and that barriers to entry are low.
90. The Transaction results in a reduction in the number of effective competitors from two to one on the Overlap Flow. Set against this, the OFT notes the presence of possible constraints from other nearby transport alternatives, such as the First services along the Oldham Road and the Metrolink tram services. Furthermore, as set out above, the revenue from the Overlap Flow amounts to approximately [less than 25] per cent of the revenue from the entire route for Stagecoach, which might limit the effect on Stagecoach's decision-making in respect of the competitive parameters on this route.

<sup>35</sup> Exceptions Guidance, paragraph 2.15.

<sup>36</sup> Exceptions Guidance, paragraph 2.40.

<sup>37</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 15.357.

91. Nevertheless, on balance of the evidence available to it, and bearing in mind it is the first phase authority, the OFT considers that it is more likely than not the case that the merger will result in a SLC. In other words, the OFT is not relying on the 'it may be case' standard in coming to its SLC finding.<sup>38</sup>

### **Magnitude of competition loss**

92. Again, given that the OFT's identified competition concern in this case involves a merger to monopoly on the Overlap Flow, the magnitude of harm may be large.<sup>39</sup> However, there are several constraints on the parties' behaviour in this case, including the possible constraints from other nearby transport alternatives and Stagecoach's revenue from the Overlap Flow compared with its revenue from the route. Furthermore, as considered above, price rises are likely to be limited to single trip tickets, and therefore the magnitude of harm is likely to be smaller than the overlapping revenue might suggest.<sup>40</sup> As such, the magnitude of harm caused may be less than the OFT would normally expect following a merger to monopoly.
93. Furthermore, the OFT notes that the vast majority of third parties were not concerned by the Transaction. Indeed, the majority of third parties, including a number of passenger groups, considered the Transaction to be beneficial. The OFT considers that the magnitude of harm in this case points toward the application of the OFT's de minimis discretion.

### **Durability**

94. While the OFT has not been provided with any evidence that competitors are likely to enter the Overlap Flow if Stagecoach were to increase prices and/or reduce frequencies, there are a number of active competitors in the relevant area, including First and JP Travel. The likelihood of entry in this case is unclear, especially in light of the CC's conclusions regarding bus operators' unwillingness to engage in

<sup>38</sup> Exceptions Guidance, paragraph 2.33

<sup>39</sup> Exceptions Guidance, paragraphs 2.35-2.36.

<sup>40</sup> As set out above, a significant proportion of the parties' customers purchase multi-journey tickets.

head-to-head competition. This factor is therefore neutral in terms of the application of the OFT's de minimis discretion.

### **Replicability**

95. The OFT will also take account of the wider implications of its decisions in this area, and will be less likely to exercise its discretion, and therefore more likely to refer, where a merger is potentially replicable across a number of similar markets in a particular sector.<sup>41</sup>
96. The OFT considers that the nature of local bus services means there may be many similar mergers and that, using the exception in this case might create an expectation that those mergers would also be cleared – resulting in wider consumer harm. In other words, instead of undertaking a single large scale merger, a series of smaller acquisitions may take place which, taken together, may amount to a significantly larger concentration. The OFT notes that there is a real risk of this occurring in local markets, especially in local transport and retail markets.<sup>42</sup>
97. In considering the wider implications of a particular decision whether to exercise the de minimis discretion, the OFT may also have regard to the economic rationale behind an individual transaction.<sup>43</sup> Stagecoach submitted that the rationale for the Transaction is to expand into North Manchester, allowing it to compete more actively with First Group and JP Travel. Although this is generally supported by third party comments received by the OFT, Stagecoach's internal documents referred to above indicate that most of the synergies anticipated from the Transaction would be derived from merging services 76 and 77 and that Stagecoach is considering removing a bus from the route.
98. Overall, the OFT considers that consideration of the deterrence value of this decision points against the exercise of its de minimis discretion.

<sup>41</sup> Exceptions Guidance, paragraph 2.4.

<sup>42</sup> The CC specifically cautioned against the OFT's use of the de minimis discretion in bus mergers. See Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 15.357.

<sup>43</sup> Exceptions Guidance, paragraph 2.43.



## Conclusion on the application of the de minimis discretion

99. The OFT has carefully considered whether exercise of its de minimis discretion in this case could give rise to the risks identified by the CC in its report on local bus services.<sup>44</sup> However, the OFT considers that the balance of factors set out above is in favour of the exercise of its de minimis discretion. The OFT therefore considers that, to the extent that the duty to refer may be met, it would be appropriate to exercise its de minimis discretion in this case.

## DECISION

100. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act'.

<sup>44</sup> Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011, paragraph 15.357.