

**Completed acquisition by the Diamond Bus Company Limited of the bus business of Firstgroup plc in Redditch and Kidderminster**

ME/5996/13

The OFT's decision on reference under section 22(1) given on 23 August 2013.  
Full text of decision published 18 October 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. **The Diamond Bus Company Limited ('Diamond')** is a wholly owned subsidiary of Rotala plc (**'Rotala'**), an AIM listed company operating commercial and subsidised bus services. Rotala operates through four different brands (Diamond, Preston Bus, Wessex and Hallmark) across the North West, South West, Midlands and London areas of England. Rotala's turnover in 2012 was approximately £54.9 million.
2. **First Midland Red Buses Limited ('First')** is a wholly owned subsidiary of FirstGroup plc. The business which is the subject of the transaction (the Redditch and Kidderminster business of First) (**'First R&K'**) operates commercial and tendered bus services. First R&K's turnover in 2012 was approximately £5.2 million.

**TRANSACTION**

3. On 2 March 2013, Diamond and First signed a sale and purchase agreement under which Rotala, through Diamond, acquired the business and assets operated from First's depots in Redditch and Kidderminster (First R&K). These assets include 36 vehicles, 108 employees, and two bus depots (one in Redditch and one in Kidderminster). The consideration was £1.5 million.

4. Following announcement of the Transaction on 24 January 2013, an Office of Fair Trading ('OFT') enquiry letter was sent on 28 February 2013. The Transaction completed on 2 March 2013. The administrative deadline for an OFT decision is 23 August 2013 and the statutory deadline is 29 August 2013.

## JURISDICTION

5. As a result of this transaction, Rotala and First R&K (together, the 'parties') have ceased to be distinct. The OFT considers that First R&K constitutes an enterprise for the purposes of determining whether a relevant merger situation has been created under the provisions of the Enterprise Act 2002 ('the Act'). This is because First R&K includes buses, two depots (used for the bus services operated by First in Redditch and Kidderminster) and employees engaged in these services.<sup>1</sup>
6. The parties overlapped in the provision of bus services in Worcestershire. The combined share of supply of the parties of local bus services in Worcestershire, on the basis of passenger journeys originated in Worcestershire (boardings) is greater than 25 per cent, with an increment attributable to the merger.<sup>2</sup> The OFT considers that the share of supply test in section 23 of the Act is met.
7. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## COUNTERFACTUAL

8. The OFT generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However,

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<sup>1</sup> These are factors which the OFT considers point to the transfer of an enterprise. See *Mergers Jurisdictional and procedural guidance* (OFT527, June 2009), paragraphs 3.8-10.

<sup>2</sup> While precise share of supply data in Worcestershire has not been provided by the parties, information provided by third parties and published statistics indicate that around 16.5 million passenger journeys were provided in local bus services in Worcestershire in 2011/12, on the basis of the total number of boardings, of which Rotala accounted for at least [] million passenger journeys, whereas First R&K accounted for at least [] million passenger journeys boarded in Redditch and at least [] million passenger journeys boarded in Kidderminster, giving a share of supply of circa [30-40] per cent. For the purposes of these calculations, local bus services are considered to be scheduled stopping services registered with the Traffic Commissioner.

it will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic.<sup>3</sup>

9. In the context of an exiting firm (or an exiting division of a firm) scenario, the OFT will only depart from the pre-merger conditions as the appropriate counterfactual if it:
  - (i) believes (on the basis of compelling evidence) that it is inevitable that one of the firms would exit the market
  - (ii) is confident that there was no substantially less anti-competitive purchaser for the firm or its assets, and
  - (iii) believes that the exit of the firm and its assets would not have been a substantially less anti-competitive outcome than the merger (with regard to what would have happened to the sales of the firm upon its exit).
10. Where the OFT is unable to reach a sufficient level of confidence on each of the above considerations, it will use the pre-merger competitive conditions as the relevant counterfactual.<sup>4</sup>
11. Rotala submits that each of the merging businesses was making losses in Redditch prior to the merger and that, in the absence of the merger, the most plausible scenario would have been First's exit from Redditch. Further, Rotala submits that the only viable future for the businesses of Rotala and First R&K in Redditch was to combine the respective depots into one, hence making significant overhead reductions, which it plans to achieve following completion of the Transaction.
12. The OFT has considered the appropriate counterfactual against which to assess the Transaction. This consideration relates to the provision of bus services in Redditch, where the main overlap between the parties is.<sup>5</sup>

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<sup>3</sup> *Merger Assessment Guidelines* (CC2 and OFT1254, September 2010), paragraph 4.3.5.

<sup>4</sup> *Ibid.*, paragraph 4.3.10.

<sup>5</sup> The OFT notes that the presence of Rotala in Kidderminster is very limited. The counterfactual issue as regards Rotala has therefore been addressed in relation to Redditch in particular.

## **Inevitable exit**

13. First has informed the OFT that the sale of First R&K was part of a wider restructuring plan whereby First would sell or exit from its less profitable bus businesses. First submits that its strategy in the last 12 to 18 months prior to the Transaction was to identify operations where current financial returns are inadequate (and the prospects for generating acceptable returns in the medium term are unlikely), with a view to disposing of those operations to allow it to focus on core operations. According to First, the forecast performance of the Redditch and Kidderminster depots indicated that these were making a loss and were unlikely to return to profitability within a visible timescale. As a result, First submits that, absent the merger, it would have been more likely than not that First would have exited the market in both Kidderminster and Redditch.
14. The OFT has sought to assess in particular whether it was inevitable that First would have exited Redditch, that is, whether First would have closed the Redditch depot and it would have stopped providing the services operated from that depot. Should First have continued to operate in Redditch absent the Transaction, the OFT would consider pre-existing competition as the appropriate counterfactual to assess the effects of the merger in Redditch against.
15. The OFT has tested the inevitability of First's exit from Redditch against the following four types of evidence: exit plans, the rationale for exit, a comparison with other depot closures by First, and considerations regarding the sustainability of the level of competition in Redditch pre-merger.
16. As regards plans to exit Redditch, whilst First informed the OFT that it would have been more likely than not that First would have exited Redditch, it could not establish with sufficient certainty the inevitability of exit. First confirmed that a decision to exit Redditch absent the sale of their Redditch depot was never taken by First and indeed there was some prospect that First would have continued to operate in Redditch. Further, First did not present the OFT with any documentation assessing or

approving exit of First from Redditch and Kidderminster in the event that the merger did not eventuate.<sup>6</sup>

17. With regard to the alleged rationale for exiting Redditch (insufficient profitability), the evidence available to the OFT shows that the business of First in Redditch was not loss making in the financial year 2010/11. While losses were recorded in 2011/12, such losses were later reduced in the last financial year before the merger (2012/13). Over the three years combined, First's operations in Redditch were profitable. In light of this evidence, the OFT believes that the First business in Redditch may have returned to profitability.<sup>7</sup>
18. Rotala submits that the exit of the Redditch business by First would be part of and consistent with a wider corporate strategy to focus on certain core activities, of which other examples have been provided, notably First's recent exit from Northampton (First having attempted and failed to sell its bus assets there) and North Devon (exit following the OFT's reference to the Competition Commission (CC) of the sale of First's North Devon business to Stagecoach Group plc). However, there are significant differences between those two cases and the Redditch depot in the evidence available to the OFT.
19. As regards Northampton, the internal documentation provided by First pre-dating the Transaction refers to the First business in Northampton as a candidate for closure. No equivalent references to the Redditch business have been provided to the OFT in this case. The OFT also notes First's attempts to sell its Northampton business form part of the same project under which the Redditch and Kidderminster business were offered for sale. However, according to First's internal documentation, [ ].
20. In light of the above evidence, the OFT is not sufficiently certain that First R&K would have inevitably exited in the absence of the Transaction. As a result, the OFT does not believe that the exiting firm scenario applies in

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<sup>6</sup> By contrast, First was able to provide the OFT with documentary evidence of exit in *Anticipated acquisition by Stagecoach Group plc of the North Devon business and assets of First Devon and Cornwall Limited*, OFT, 10 July 2012.

<sup>7</sup> Further, the OFT has sought to compare the losses that would have been avoided through exit against the expected cost of exit, as reflected in First's internal documentation. This evidence tends to indicate that, even if the losses of 2011/12 had been sustained over a continued period of time, First may have been better off by maintaining the operations in Redditch.

this case and it believes that the relevant counterfactual is the pre-merger conditions of competition.

21. Given the findings of the OFT in relation to the inevitability of exit of First R&K, the OFT does not need to decide on whether the second and third limbs of the exiting firm scenario are met.

### **Exit of Rotala**

22. Rotala submits that, due to the increasing constraints on its Redditch business, leading to significantly reduced profit margins, it had considered several options in relation to the future of its Redditch business prior to the Transaction, including both withdrawing from the area and acquiring the First business in Redditch.<sup>8</sup> Further, Rotala submits its view that the combination of its business in Redditch and the First R&K business will create a profitable and sustainable business for Redditch which would not otherwise exist. This will be primarily the result of the reduction in overhead costs in to a single business in Redditch, including, amongst others, staff and rent costs.
23. As regards the possibility that Rotala would have exited its operations in Redditch, while the OFT has been provided with information indicating that certain parts of the business may have incurred losses, Rotala has not submitted any evidence that it would inevitably have exited in the absence of the merger. None of the evidence that emerged during the OFT investigation indicates that Rotala was actively considering the possibility of exiting Redditch or that it attempted to sell or close its Redditch business.
24. Further, Rotala also submits that its withdrawal from service 51 would have taken place absent the merger and therefore the OFT should not assess the merger on the basis that there is an overlap between the parties on routes 50 and 51. The OFT has discussed this below (paragraphs 60 to 68).
25. The OFT cannot therefore conclude that Rotala would have exited the Redditch area in the absence of the merger. As a result, the OFT does not

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<sup>8</sup> A third option, according to Rotala, would have been to increase its prices in Redditch, although this would not have been viable, as demand for the Rotala services in Redditch would have shifted away (according to Rotala) to other bus operators or other means or transport.

consider the exiting firm scenario applies in this case and considers that the relevant counterfactual is pre-merger conditions of competition.

### **Conclusion on counterfactual**

26. Since the OFT is unable to conclude that either First R&K or Rotala would have inevitably exited the market, the OFT has adopted the pre-merger conditions of competition as the appropriate counterfactual for assessing the merger.

### **FRAME OF REFERENCE**

27. Pre-merger, the parties overlapped in the provision of local bus services (commercial and tendered) and in the bidding for tender contracts in Redditch.

### **Product scope**

#### Commercial bus services and competition for tenders

28. In past merger decisions<sup>9</sup> and in the CC's local bus market report, the OFT and the CC concluded that competition for tenders should be analysed separately from the provision of local commercial bus services, while taking into account that there may be some linkages between commercial and tendered services.<sup>10</sup>
29. The OFT's investigation has not uncovered any evidence that contradicts this approach. Therefore, the OFT assesses competition for tender contracts separately from the provision of commercial bus services.

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<sup>9</sup> See for example, *Anticipated acquisition by Arriva Northumbria Limited of the bus operations of Go North East Limited in Ashington, Northumberland*, OFT, 11 February 2010; *Anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited*, OFT, 23 December 2009; and CC Report in *Completed acquisition by Stagecoach Group plc of Preston Bus Limited*, 11 November 2009.

<sup>10</sup> CC, Local bus services market report, (*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.

## Competition for tenders in school buses and local buses

30. Tender data in this case suggests that the parties only compete in tenders for local buses and that they tend not to participate in tenders for school buses. Moreover, the tender data demonstrates that the bidders for local buses are different to those bidding for school bus services. For instance, for local bus services in Redditch the parties compete in tenders with a significantly lower number of competitors than the number of competitors bidding in the same area for school buses. Accordingly, the OFT considers that tenders for school bus services should be excluded from the market for tenders in local buses. In the absence of any material overlap between the parties in tenders for school buses this is not considered further.

## Commercial bus services and tendered bus services

31. The OFT notes that in its local bus market report the CC found that commercial and tendered services can constitute alternatives from a demand-side perspective:

'For passengers, supported bus operations provide a service in the same way as they would for a commercial route. Indeed, on many supported routes passengers would be unaware that they are travelling on a tendered service. A passenger is therefore likely to substitute between supported and commercial bus services in those cases where they provide an alternative for the passenger's journey...We conclude that commercial and supported services are both part of the relevant markets for the provision of bus services.'<sup>11</sup>

32. The OFT has not been provided with evidence in this case that indicates overlapping commercial and tendered services do not compete from a demand-side perspective (that is from the perspective of a passenger seeking to travel from one point to another). The OFT pays particular attention to demand-side factors when identifying the relevant frame of reference.<sup>12</sup>
33. The OFT accepts that supply-side factors may affect the competitive dynamic between overlapping commercial and tendered services and, in

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<sup>11</sup> CC, Local bus services market report, paragraph 7.114.

<sup>12</sup> See *Merger Assessment Guidelines*, paragraph 5.2.6.

particular, the specific parameters over which such different services may be competing. However, it is not clear that these factors exclude the prospect of any competition between overlapping commercial and tendered services. Therefore, the OFT considers it appropriate to include commercial and tendered services in the same frame of reference, other things equal, for the purpose of identifying overlaps between the parties. The impact of the supply-side restrictions on tendered services is considered in the competitive assessment.<sup>13</sup>

### **Other forms of transportation**

34. Rotala submits that other forms of transport such as rail, car, taxi, cycling and walking are substitutes to bus services.
35. The OFT takes note of the CC's local bus market report which states that the evidence does not suggest that other modes of transport constitute a competitive constraint on bus operators:

'Customers may have a choice between alternative modes of transport to complete their journey. Many of the operators and other parties such as LTAs said that, in particular, the car was a competitive constraint on bus operators. However, the evidence did not support their view. We found that not enough passengers would switch to other modes of transport in response to small changes in the competitive variables, such as fares, for this to act as a competitive constraint which would warrant widening the relevant market

Instead, the propensity of individuals to use the bus is driven more by other factors such as their income, life stage, how close their home is to a bus stop, whether the individual has access to a car and so on'.<sup>14</sup>

36. The OFT has not received any evidence to suggest that the constraint imposed by private cars, journeys on foot or by bicycle would be sufficient to render unprofitable an increase in the price or deterioration in quality of local bus services in this case. Therefore, the OFT considers that the frame

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<sup>13</sup> This approach to the frame of reference is consistent with the OFT's approach to overlapping commercial and tendered services in previous decisions. See for example, *Completed acquisition by Go-Ahead Group plc of Arriva plc's Horsham (West Sussex) business*, OFT, 16 November 2009).

<sup>14</sup> CC, Local bus services market report, paragraph 20 to 21. See further paragraph 6.144 ff.

of reference should not include forms of transport other than local bus services.

## **Geographic scope**

### **Flow level**

37. Consistent with previous cases, the OFT has assessed the impact of the transaction on a flow-by-flow basis, where a 'flow' is defined as a connection between two specific points.<sup>15</sup> In many instances an individual flow will be only a part of the overall route. This approach is taken because passenger demand is for travel between two points. The OFT has also considered whether nearby flows on other routes may be in the same market, given the CC's finding that flows that have their origin and destination within 500 metres of one another are likely to be demand-side substitutes.<sup>16</sup>

### **Network level**

38. Consistent with previous cases, the OFT considers it may be appropriate to assess the impact of the merger at a network level in addition to competition on specific point-to-point flows. Competition between bus operators may occur on a number of different geographic levels (including specific flows, routes or across wider local areas or, for example, at the depot level). The appropriate geographic area depends on the nature of the constraints faced by local bus operators.
39. As regards demand-side considerations, there is evidence to suggest that some customers may use the parties' services to make multi-journey (as opposed to point-to-point) trips across their networks. 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.

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<sup>15</sup> Although due to data availability analysis has not been possible at the granular level of each individual origin and destination flow. As a result, flows are aggregated where competitive conditions for a set of flows are the same.

<sup>16</sup> CC Report in *Completed acquisition by Stagecoach Group plc of Preston Bus Limited*, 11 November 2009.

40. Rotala and First R&K overlap in the supply of bus services in Redditch.<sup>17</sup> The OFT therefore considers it appropriate to assess the merger in relation to the supply of network bus services in Redditch.

### **Competition for tender contracts**

41. In previous cases the OFT has considered the geographic frame of reference for tenders to be sub-national, based on the region where the tenders are offered.<sup>18</sup> This is consistent with the CC's local bus market report which found that the market for tenders will generally include all bus operators with a depot in the local area.
42. Tender data provided in this case demonstrates that the bidders for a particular route typically vary by local area. Given First R&K's activity, the OFT considers the main overlap in tenders between the parties to have been in Redditch.<sup>19</sup> Nevertheless, the OFT takes account of possible constraints from operators based outside of Redditch where evidence suggests they may provide a constraint (through, for example, their bidding activity for tendered services in Redditch).

### **Conclusion**

43. The OFT considers that the appropriate frames of reference for consideration are:
- (a) local bus services (commercial and tendered) on overlapping flows
  - (b) local bus services in Redditch at a network level, and
  - (c) competition for tender contracts in Redditch.

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<sup>17</sup> The parties submit that there is only a minimal overlap in Kidderminster, as Rotala is not present there.

<sup>18</sup> *Anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited*, OFT, 23 December 2009.

<sup>19</sup> Prior to the Transaction, First was active in bidding for WCC contracts across Worcestershire. While the OFT cannot draw a clear distinction between those tenders that would have been bid for by First to operate from its depots in Redditch and Kidderminster and those that would have been operated from other depots, it is clear that First R&K's activity was principally focused in the Redditch and Kidderminster areas and the overlap between the parties was principally in the Redditch area. As a result, the OFT considers appropriate to focus its assessment on the tenders related to services in the Redditch area.

## UNILATERAL EFFECTS

44. The OFT has assessed the Transaction's effect on commercial and tendered services in Redditch. In doing so, the OFT has examined whether as a result of the merger there is a realistic prospect that prices will rise, frequencies will decrease and/or the quality of the parties' service offering will otherwise be worsened.

## COMPETITION ON INDIVIDUAL FLOWS

45. Redditch bus services are organised around the Redditch bus station, which is located in the town centre. The parties' depots are also located near the bus station.
46. The main overlaps between the parties' bus services were on a circular bus route (routes 57 and 58) and in two main route corridors in Redditch. These are summarised in **Table 1** below. There were partial overlaps indicating that other routes may also be substitutes for certain passenger journeys.

**Table 1 Summary of key overlaps**

Key overlaps
Route 57/58
Redditch town centre to Batchley (routes 50 and 51)
Redditch town centre to Crabbs Cross

### Route 57/58

47. Rotala and First R&K each operated route 57/58 on a commercial basis pre-merger. This is a circular, bi-directional route, of a distance of approximately 8 miles, connecting Redditch bus station to the Matchborough area through Studley Road by the western side of the route, and the Church Hill area by the northern side of the route. This route attracts the largest number of bus passengers in Redditch.
48. The parties overlap across the entire route. Therefore, the OFT has assessed competition on this route as a whole. The assessment of the

extent to which third party services compete on specific segments of this route is addressed in detail below as necessary.

49. The OFT considers that there was intense head-to-head competition between the parties on this flow pre-merger, as they:
- Operated the same service, which extends for the entire length of the route.
  - Operated their services with similar registered frequencies, that is, most of the time as 'frequent services' (one bus every 10 minutes or less).
  - Operated similar high frequency services on the route and pre-merger faced no competing operators with a similar frequency.
  - Offered a similar range of ticket types and prices, which included a similar single ticket fare and the availability of route specific day tickets (First R&K's targeted daily ticket included both route 57/58 and route 51, whereas Rotala's targeted ticket only included route 57/58).
  - Operated a similar number of buses on the route pre-merger (First R&K was operating up to 11 vehicles, Rotala up to nine).
50. In line with previous findings of the CC, the OFT considers that, for a competitor to be effective in relation to frequent services (that is services operated every 10 minutes or less), it would have to run its services with a frequency of no more than 10 minutes greater than the incumbent.<sup>20</sup> In these circumstances frequent services operated on an overlapping flow provide a strong competitive constraint upon each other.
51. Further, both the parties and third parties have provided extensive evidence that the parties actively competed for passengers on this route, which resulted in the actual frequencies of the bus services operated during the 'frequent service' period being higher than a bus every 10 minutes. Rotala submits that the effective combined frequency at which buses were run by the parties on this route was at times as high as a bus every two to three minutes.

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<sup>20</sup> See, for example, CC Report in *Completed acquisition by Stagecoach Group plc of Preston Bus Limited*, 11 November 2009, Appendix I, paragraph 14.

52. Examples have also been provided by the parties of price competition, including through the use of temporary promotions available on route 57/58 only (Diamond campaign of December 2012).
53. Rotala identified a number of bus services overlapping with the parties on route 57/58 or part of it.<sup>21</sup> The OFT notes two general points in relation to these competitors. First, some of these services only overlap with the parties on a portion of the 57/58 routes and so could only ever represent a feasible alternative for passengers on those specific flows of the 57/58 on which the competitor operates and so the extent of the competitive constraint exerted by that competitor, by the nature of the overlap, is limited.
54. Second, as mentioned above, the CC has in the past found that, for one operator to provide an effective constraint on another operator in relation to the provision of frequent services (that is, services operated every 10 minutes or less), it would have to run with a frequency no more than 10 minutes greater. None of the services described below meets this criterion, as set out below:<sup>22</sup>
- a) **Service X50** (operated by Johnsons) overlaps with the 57/58 over two miles on the northern side of the 57/58 route. However at the time of the merger, the X50 was operated at a lower frequency than buses 57/58 (one trip per hour or at least six times less frequent than each of the parties' services). The OFT therefore concludes that this service did not represent an effective competitor to the 57/58 services at the time of the merger.

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<sup>21</sup> In addition to the services considered here, the parties have also noted that services 26, 248, 354 and 512 each overlap with the 57/58 services, but only over a distance of approximately 0.3 miles from the Redditch bus station. Moreover, these services generally run at a frequency considerably lower than the 57/58 services. Based on these considerations, the OFT does not consider it necessary to include these services on the competitive assessment of the 57/58 route but notes that the additional competitive overlap between the parties as a result of these services only serves to exacerbate the OFT's concerns regarding the competition lost as a result of the merger.

<sup>22</sup> Where competitors operate at a frequency significantly lower than that of the parties, the competitive constraint exerted by that competing operator will be very limited due to the requirement for passengers, in order to switch to a competing service, to wait for a significant period of time, or to plan their journey well in advance. Even if this was likely, the more limited frequency of a competing service also points to limited capacity of those competitors relative to the capacity offered by the parties.

- b) **Service 50A** (operated by Green Bus) overlaps with the 57/58 service over two miles on the northern side of the 57/58 route. This service was operated, pre-merger, at a considerably lower frequency than service 57/58 (one trip per hour). The OFT considers that this service did not represent an effective competitor to the 57/58 services at the time of the merger.
  - c) **Service 350** (operated by Dudley's Coaches and the Worcestershire County Council ('WCC')) fully overlaps with the 57/58 services but runs only twice a day in the case of the Dudley's Coaches service and every three hours in the case of the WCC service. Based on the above considerations the OFT considers that this service does not represent an effective competitor to the 57/58 services.
  - d) **Service 59** (operated by Redditch Dial-A-Ride) operates with the aim of providing a bus service to passengers heading from the Church Hill area to the Alexandra Hospital. Service 59 runs once every hour from 9.30 to 3.45 (Monday to Friday). Therefore, it runs at a considerably lower frequency than the parties' services and, moreover, for a limited time during the day. The OFT therefore concludes that this service does not represent an effective competitor to the 57/58 services.
55. Rotala submits that competitors seeking to expand their service frequency on the 57/58 route or part of it would not encounter major difficulties. Rotala, in particular, provided evidence that two operators would be planning to expand on this route. The OFT examines the threat from potential entry in paragraphs from 95 to 106 below.
56. The OFT has also considered whether in aggregate the third party services listed in paragraph 54 above were sufficient to constrain the parties pre-merger, in the parts of the 57/58 route where more than one of them overlapped with the services of the parties. However, the OFT believes that even in aggregate they would not, since competing services only ran in aggregate at a maximum of two buses per hour (services X50 and 50A, which overlapped with each other and the services of the parties over two miles on the northern side of the 57/58 route). In addition, and importantly, these third party services do not run on the entire 57/58 route and therefore any competitive constraint or additional choice for bus users would only apply to relatively limited flows along the route.

## **Post-merger evidence**

57. The OFT has received a number of complaints from passengers in relation to a deterioration of the quality of the 57/58 service operated by Rotala after the merger. Bus passengers complained that the frequency and reliability of the services have been considerably reduced. Some passengers told the OFT that in some occasions they had to wait for up to 30 minutes for the first bus to arrive, as compared to the frequent services (every 10 minutes or less) operated by each of the parties pre-merger.
58. The OFT has not been able to verify the accuracy of these submissions and notes that the period in which this anecdotal evidence has been received has been reasonably short. However, the OFT considers this qualitative evidence relating to a possible deterioration of service quality occurring post-merger may point to unilateral effects having arisen from the merger.

## **Conclusion on route 57/58**

59. On the basis of the above evidence, the OFT considers that the parties competed with each other on the route pre-merger to the benefit of passengers. The merger therefore reduces the number of effective competitors on this route. The OFT believes that the merger raises a realistic prospect of a substantial lessening of competition in relation to the circular route 57/58 (and each of the flows on it).

## **Redditch town centre to Batchley**

60. Prior to the merger, the parties operated the following services from the Redditch bus station to the Batchley area, a largely residential area about two miles West of the town centre:
- Rotala: route 50 and route 51
  - First R&K: route 51<sup>23</sup>

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<sup>23</sup> There are further First services going to or through Batchley, including 143, 145 and X3. However, these are generally services leaving Redditch towards other parts of Worcestershire, running at a considerably lower frequency than routes 50 and 51. Based on these considerations, the OFT does not consider it necessary to include these services on the competitive assessment of the corridor to Batchley as they have no material impact on the competitive assessment.

61. The OFT has considered whether the parties overlap in relation to each of route 51 and the route 50 and route 51 pair.
62. Rotala submits that there is no overlap on route 51, as Rotala decided to withdraw its registration for service 51 prior to the merger and for reasons unconnected to the merger.
63. The evidence provided to the OFT shows that Rotala had requested the withdrawal of its 51 service before or at the time when it decided to purchase First R&K (December 2012), due to []. The effective withdrawal of Rotala's 51 service took place the first day following completion of the merger (4 March 2013), which Rotala attributes to the lead times for withdrawing a service registration.
64. First submitted that its negotiations with Rotala were at an advanced stage around October/November 2012 (that is at least one month before the decision to deregister the route) and that an agreement in principle between First and Rotala for the sale of First R&K to Rotala was reached no later than in December 2012.
65. Therefore, the OFT has been unable to conclude that Rotala's service 51 was discontinued independently of the merger such that the overlap on this route no longer arises. On a cautious basis, the OFT has assessed the competition effects in this corridor on the basis that the parties overlapped in the provision of the 51 service pre-merger.
66. Services on route 51 were provided on a commercial basis by both First R&K and Rotala pre-merger. The typical frequency of the First R&K services was six buses per hour (that is, most of the time as 'frequent services', with one bus every 10 minutes or less) Monday to Saturday and three buses per hour on Sundays. The typical frequency of the Rotala services was three buses per hour Monday to Sunday. Ticket prices were similar or the same for the two operators.
67. Rotala submits that its own service 51 was not competing with First R&K's 51, as the frequency was considerably lower and []. However, in previous cases the CC has adopted an analytical method to distinguish bus services

by the frequency of their routes,<sup>24</sup> according to which, for services less frequent than every 10 minutes, competitors running with frequencies no more than twice as long were considered effective competitors (and in the same market).

68. On the basis of those considerations, the OFT concludes that the parties did compete on route 51 pre-merger.
69. As regards routes 50 and 51, while these do not overlap in full, they both provide the same point to point service (Redditch bus station to Batchley) and do not generally diverge more than 500 meters from each other throughout their respective routes. As such the OFT therefore considers that routes 50 and 51 may be substitutes from a demand-side perspective.
70. In contrast to route 51, route 50 is a subsidised service running return journeys from the Redditch Bus station to Batchley once per hour (seven daily in total), from Monday to Saturday. Given the broad geographic overlap, the OFT considers that the Rotala 50 service may have provided a competitive constraint to First R&K's 51 service, albeit a more limited one due to the comparatively smaller frequency of Rotala's service 50 (six times less frequent than First R&K's service 51).<sup>25</sup> Nevertheless, the provision of the hourly 50 service by Rotala would have reinforced the overall Rotala offer in competition with First R&K's service 51 on this corridor.
71. Rotala has identified one bus service overlapping with the parties on route 51, that is service **52** operated by Dial-a-Ride. The OFT notes that the frequency of the 52 service is 6 services a day, Monday to Friday only (that is less than half the frequency of the least frequent of the parties' services). Third parties have noted that Dial-a-Ride's service 52 provides a 'community transport service' that aims to support passengers with limited travel options and is unlikely to represent a strong competitive constraint

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<sup>24</sup> See, for example, CC Report in *Completed acquisition by Stagecoach Group plc of Preston Bus Limited*, 11 November 2009, Appendix I, paragraph 14.

<sup>25</sup> The OFT also recognises that the competitive impact of combining overlapping commercial and tendered services is different to combining overlapping commercial services. For example, the contractual stipulations on fares and frequencies may limit the merged entity's ability to deteriorate the offering of the tendered service. However, in some of its previous decisions, the OFT has been unable to exclude the prospect that combining tendered and commercial services could result in competitive harm notwithstanding the constraints imposed by the tender contract.

on the parties. Further, this service largely overlaps with the 51 services, except from the boundary of the Enfield Industrial Estate. The key difference between the two routes is their starting point, which for route 52 is the Abbey Stadium Sports Centre, a point located further than 500 meters away from the starting point of services 50 and 51 at least for part of the flow (the connection to the Redditch bus station).

72. Based on the above considerations, the OFT concludes that service 52 does not represent an effective competitor to the parties.

### **Conclusion on the flow between Redditch town centre and Batchley**

73. On the basis of the above evidence, the OFT believes that the merger may give rise to a substantial lessening of competition in these flows.

### **Redditch town centre to Crabbs Cross**

74. Prior to the merger, the parties operated the following services from the Redditch bus station to the Crabbs Cross area:<sup>26</sup>

- Rotala: route 70/70A<sup>27</sup>
- First R&K: routes 55/55A/56/56A<sup>28</sup>, 26 and 247<sup>29</sup>

75. The parties overlapped in the provision of services between the Redditch bus station and the Crabbs Cross area, through the above listed routes. Most of those routes run through Mount Pleasant and Evesham Road, with the exception of route 55/56, which is a circular route making a longer detour both sides of Evesham Road beyond a point in Headless Cross, and which also serves Plymouth Road. Some of these routes go further south from the Crabbs Cross area and leave Redditch towards Astwood Bank (70), Evesham (247) and Stratford-upon-Avon (26).

76. The provision of those services was as follows before the merger:

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<sup>26</sup> For the purposes of this decision the OFT refers to the Crabbs Cross area when discussing the area around the junction of Evesham Road, Rough Hill Drive, The Slough and Windmill Drive.

<sup>27</sup> For simplicity, these are referred to as route 70 in this decision.

<sup>28</sup> For simplicity, these are referred to as route 55/56 in this decision.

<sup>29</sup> The OFT notes that Route 70 has also been served in the past by First.

- Services on route 70 were provided by Rotala on a partially subsidised basis (Rotala was operating the route mainly on a commercial basis but was also receiving a subsidy to operate specific services). The typical frequency was two buses per hour Monday to Saturday.
  - Services on route 55/56 were provided by First R&K on a commercial basis, with a typical frequency of one bus every 20 minutes Monday to Saturday.
  - Services on route 247 were provided by First R&K on a commercial basis, with a typical frequency of one bus per hour, Monday to Saturday.
  - Services on route 26 were provided by First R&K on a commercial basis, with two buses per day being run from Monday to Friday.
77. The OFT considers that on a cautious basis the services provided by the parties may have acted as a competitive constraint on each other on some of the flows between Redditch Centre and the Crabbs Cross area (where the bus stops for the two services are within 500 metres of each other route). As discussed above, tendered and commercial services are usually seen as substitutes by passengers and as such they provide a competitive constraint on each other.
78. The OFT considers that, while the characteristics of the specific services provided by the merging parties may differ, it cannot be ruled out on a cautious basis that they are seen as direct alternatives by passengers. For example, while the service 55/56 may go a longer distance to get to Crabbs Cross than service 70, buses run more frequently on the 55/56 service, which may strengthen the perception of substitutability for passengers. Further, the provision of the hourly 247 service by First R&K would have reinforced the overall First R&K offer in competition with Rotala's service 70 on this corridor.
79. There are a number of third party bus services running between the Redditch bus station and the Crabbs Cross area, all of them through Evesham Road, including services R2 (NNCreswell), 350 (Dudleys and the

WCC), 354 (WCC) and 512 (A and M Group).<sup>30</sup> With the exception of the service 26 operated by Stagecoach, all these services run at a significantly lower frequency than the parties' services (between a bus every three hours and a bus per hour and twice a week) and do not represent, in the view of the OFT, a competitive constraint on the parties' services.

80. As regards the hourly service 26 operated by Stagecoach, the OFT acknowledges that Stagecoach may represent a competitive constraint to the parties post-merger, albeit this may only provide a more limited constraint on the combined services run by the parties post-merger, which are six times more frequent on a combined, per-hour basis than the Stagecoach service, according to the service registrations in place at the time of the merger. Further, even if Stagecoach represents an effective competitor, the OFT remains concerned by the reduction in the number of operators on this flow from three to two and the effects this may have on competition and services to passengers.

#### **Conclusion on the flow between Redditch town centre and Crabbs Cross**

81. On the basis of the above evidence, the OFT believes that the merger gives rise to a realistic prospect of a substantial lessening of competition on these flows.

#### **Conclusion on overlap flows**

82. On the basis of the above evidence, the OFT believes that it is or may be the case that the merger has resulted, or may be expected to result, in a substantial lessening of competition in the supply of local bus services in individual overlap flows, including route 57/58, the Redditch to Batchley flows and Redditch to Crabbs Cross flows.

### **NETWORK COMPETITION**

83. The OFT has considered whether the merger gives rise to a loss of actual competition between Rotala and First R&K at a network level, such that the effects of the merger could be expected to extend beyond the overlap flows.

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<sup>30</sup> Service 248 is also run by Johnsons Coaches on Sundays. As the parties' services in this corridor do not operate on Sundays, there would not be an overlap with the parties' services at all.

84. As noted by the CC in its report on local bus services, network effects may influence bus operators in terms of how best to attract passengers buying multi-journey tickets. Multi-journey tickets are more valuable to customers where the size of the network is larger. Operators benefit from customers purchasing multi-journey tickets as it locks passengers in to their services to the exclusion of rivals.<sup>31</sup> Consequently, network effects may result in an operator providing better quality services across their network compared to a situation where they were interested in single-journey passengers alone. Therefore, the OFT has investigated whether this merger could lead to an increase in prices or a worsening of the parties' service offering on a network level.
85. The OFT notes that multi-journey tickets account for a significant proportion of the parties' revenue, suggesting that there is customer demand for multi-journey products.<sup>32</sup>
86. Further, according to the route maps provided by Rotala, the parties operated the same number of routes in Redditch (nine) before the merger.<sup>33</sup> As discussed above, the parties' networks overlap in several routes and/or corridors, and each of their networks is spread across most parts of Redditch.
87. However, the OFT notes that the vast majority of passengers travel on routes where the parties overlap, namely routes 57/58, 70, 55/56 and 51. These overlaps have already been considered by the OFT (above). Given the findings of the OFT in relation to the overlaps on the relevant individual flows, the OFT has not found it necessary to conclude on the merger's effect on competition in network services since these individual routes account for such a large proportion of the parties' activities in Redditch. Therefore, the incremental harm caused by any loss of network competition would be small in any event, and an extension of the harm resulting from the loss of competition on individual routes.

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<sup>31</sup>CC, Local bus services market report, paragraphs 8.50 to 8.56 and 9.66 to 9.71.

<sup>32</sup> Multi-journey tickets (that is tickets for an unlimited amount of travel) are sometimes valid in one route (for example, the parties have in the past sold tickets valid on their 57/58 services only), but are more often offered for use in multiple routes. Multi-journey tickets which are valid in the services of multiple operators are generally referred to as multi-operator travelcards.

<sup>33</sup> This includes Rotala's 51 service, which the OFT considers should be counted both as a Rotala pre-merger service, as discussed above.

## COMPETITION FOR TENDERS

88. Some routes that would not attract a sufficient number of passengers to be profitable enough and be operated as commercial routes can receive subsidies from the WCC or other transport authorities, so that they can be profitably operated by bus operators. These routes are referred to here as 'subsidised routes' or 'tendered routes'.
89. Rotala and First R&K are both active in bidding for tendered route contracts. The OFT has considered whether the merger may reduce competition for tenders, the result of which may be to increase the level of subsidy required from (that is the price paid by) the relevant transport authority.
90. The majority of subsidised routes in Worcestershire are assigned by the WCC through an open tender where the participants have visibility over the best offer and can submit a better one in response, that is, an offer to accept a lower subsidy from the WCC.
91. Pre-merger, Rotala and First R&K submitted bids to the WCC for subsidised local bus services in []. As outlined above, the OFT assessment of competition for tenders focused on tenders in the Redditch area which the OFT considers are the most likely to be affected by any loss of competition as a result of this merger.<sup>34</sup>
92. The OFT analysed bidding data which covered eight tenders in Redditch. These tenders were carried out in July 2011, as part of a wide tendering process carried out by the WCC for Worcestershire County. The OFT has found evidence of competition between Rotala and First R&K for the operation of subsidised local bus routes in Redditch.
93. The data shows that in all the WCC tenders where Rotala participated (six of the eight tenders) First R&K was also a bidder and Rotala and First R&K always submitted the top two bids. Further, in three out of six of these tenders, the parties were not facing any competition from other operators

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<sup>34</sup> The evidence available to the OFT shows that in Redditch the parties competed for tenders more closely than they competed in any other area.

and in the other three tenders the competitors' offers were from 25 to over 100 per cent worse than the parties' offers.<sup>35</sup>

94. Taking all the evidence in the round, the OFT considers that the merger would remove a significant competitive constraint for Rotala in competition for tenders, especially in relation to tenders for local bus services in Redditch. Therefore, the OFT believes that the merger gives rise to a realistic prospect of a substantial lessening of competition in the provision of tendered bus services such that subsidies paid by WCC may increase or service quality provided to bus users may decrease following future tenders.

## **ENTRY AND EXPANSION**

95. Where the combination of merging businesses raises potential concerns about the ability to increase prices or reduce quality or, in the case of transport mergers, reduce frequencies, the OFT also considers the responses of other businesses. Entry by potential rivals, or expansion by existing rivals, can mitigate the effect of a merger on competition. In assessing whether entry or expansion might mitigate a finding of a substantial lessening of competition, the focus is on whether such behaviour would be timely, likely and sufficient in scope.<sup>36</sup>
96. Rotala submits that it will be constrained by the threat of entry and/or expansion following the merger. Rotala points to its own entry in 2008 and the entry of Green Bus on parts of route 57/58 as evidence that successful entry is possible.<sup>37</sup> Further, Rotala submits that existing operators offering limited frequencies could easily enhance their offering should a profitable opportunity arise. Rotala also stresses the existence of a number of third party depots within a 30 and 40 minute drive time from Redditch, including two major bus operators (Stagecoach in Stratford-upon-Avon and National Express in Birmingham), as well as smaller operators such as Johnsons in

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<sup>35</sup> They were also the top two bidders in one instance in Wyre Forest and one instance in Bromsgrove. In these two areas, there were also three additional bids where the parties were facing a strong competitive constraint from each other, although they did not submit the best and second best offers.

<sup>36</sup> *Merger Assessment Guidelines*, section 5.8.

<sup>37</sup> In relation to Rotala's entry into Redditch, the OFT notes that this was achieved primarily through the acquisition of Go West Midlands Limited in March 2008 from the Go-Ahead Group PLC. As regards the entry of Green Bus in Redditch, this is the Service X50 which, as discussed above, connects Redditch and Birmingham.

Hanley-in-Arden, which in the view of Rotala would provide a competitive constraint on it. Some of these operators (Stagecoach, Johnsons) already run inter-urban routes into Redditch.

### **Developments following the merger**

97. Some developments have taken place in the Redditch area following the merger. To the knowledge of the OFT, these are:

- A reduction of the frequency of Service 50A operated by Green Bus, from a typical frequency of one bus per hour to one trip per day, effective from Monday 17 June 2013.
- An expansion of the route of Service X50, operated by Johnsons between Redditch and Birmingham, in the part of the route going through Redditch, which now travels via the Alexandra Hospital in Redditch (those services have been redenominated as Service 150). The new 150 services have been operated from 29 July 2013 by Johnsons, replacing a large number of the X50 services. Johnson's stated that [ ]. This represents an expansion of services on the route in which the parties overlapped.<sup>38</sup>
- A registration by City Line Travel to operate services on the entire 57/58 route (to begin the service from 26 September 2013).<sup>39</sup> City Line Travel intends to operate the service at four services per hour (every 15 minutes, excluding a one hour break around noon) from 7.45 am to 5.15 pm, Monday to Saturday. The buses would operate from City Line Travel's base in Smethwick, 15.5 miles away from Redditch. Based on the information provided by City Line Travel and the Traffic Commissioner, the OFT considers that it is likely that City Line Travel will enter route 57/58.

98. As outlined above, the OFT has assessed the Transaction relative to the pre-merger conditions of competition. Nevertheless, the OFT considers it

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<sup>38</sup> The X50 route connects Redditch and Birmingham; in Redditch it overlaps with the 57/58 route over approximately 2 miles, via the Church Hill area. The new 150 route also connects Redditch and Birmingham; in Redditch it overlaps with the 57/58 route over approximately 6 miles, via the Alexandra Hospital and the Matchborough area.

<sup>39</sup> The Notice of registration of the new 57/58 services by City Line Travel was published on 9 August 2013. Within the limited time available, the OFT discussed City Line Travel's proposed entry with City Line Travel and the Traffic Commissioner.

appropriate to take account of events that have occurred since the Transaction occurred and to assess the weight, if any, that can be attached to this information and to factor this into its overall assessment. For the reasons outlined below, the OFT does not consider events that have taken place since the merger to sufficiently assuage its competition concerns in this case.

### **Likelihood of entry and/or expansion**

99. The OFT considers not only the scale of any barriers to entry and or expansion that may impact on the likelihood of entry or expansion but also whether firms have the ability and incentive to enter the market (or the intent to do so). For example, in a market characterised by low barriers to entry and/or expansion, entrants may nevertheless be discouraged from entry by the small size of the market, or the credible threat of retaliation by incumbents (whether in the same market as the merged firm or another where that new entrant is already present).<sup>40</sup>
100. One other bus operator indicated it may possibly expand in the event of deterioration in the competitive offering of Rotala following the merger. No additional bus operator contacted by the OFT indicated that they have any current plans to enter or expand against Rotala on any of the services in relation to which the OFT has identified a realistic prospect of a substantial lessening of competition.
101. As regards the possibility of operating intra-urban services in Redditch from depots located outside the Redditch area (either by a new entrant or an operator already running services into Redditch), a majority of parties contacted by the OFT cited several factors which may reduce their ability or their incentive to pursue such operation. Chief amongst them was the 'dead mileage' that an operator from outside town would be faced with, affecting the profitability of operating from outside town.<sup>41</sup>

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<sup>40</sup> *Merger Assessment Guidelines*, paragraph 5.8.8.

<sup>41</sup> Even where the dead mileage issue could be reduced by using buses headed towards Redditch as an inter-urban service at the start or the end of the day, the times at which this could be done or the direction of travel (for example against the major commuter flow) would provide limited opportunities to reduce the cost of dead mileage.

### **Timeliness of entry and/or expansion**

102. Entry and/or expansion must also be expected to be sufficiently timely and sustained to constrain the merged firm.<sup>42</sup> The CC's market investigation found 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>43</sup> The OFT notes that the expansion of the X50 service, albeit limited, has taken place already and the entry by City Line Travel, albeit limited should it occur, could involve the operation of bus services within three months of their registration of routes. Several other third parties also confirmed that they may incrementally increase their presence in Redditch.

### **Sufficiency of entry and/or expansion**

103. To be considered a competitive constraint, entry or expansion should be of sufficient scope to deter or defeat any attempt by the merged firm to exploit any lessening of competition resulting from the merger.

104. The OFT has carefully considered City Line Travel's proposed entry. The OFT notes that City Line Travel is not an established bus operator. City Line Travel was granted a Public Service Vehicle (PSV) operator licence as recently as in March 2012, and does not operate anywhere else in the UK. The OFT is satisfied that [ ] has a business plan, including pricing, in relation to the operation of route [ ]. The OFT has no evidence of City Line Travel operating bus services in the past and notes its relatively small size compared to that of Rotala.<sup>44</sup> Furthermore, the OFT notes that City Line Travel would operate on route 57/58 at a lower frequency than either of the parties (a maximum of four services per hour as opposed to at least six buses every hour for each of the parties) and during a more limited time during the day (7.45 am to 5.15 pm) and fewer days on the week (Monday to Saturday) than the parties' operations of Monday to Sunday services, between 5.06 am and 23.05 pm).<sup>45</sup>

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<sup>42</sup> *Merger Assessment Guidelines*, paragraph 5.8.11.

<sup>43</sup> CC, Local bus services market report, paragraph 9.16.

<sup>44</sup> [ ] PSV operator licence is [ ]. According to [ ], the number of vehicles to be operated on [ ] is fewer than [ ].

<sup>45</sup> On the basis of the longest daily timetable (Fridays).

105. As regards the change in route of the Johnsons X50 service (replacing most of the current services with a new 150 service), the OFT notes that this change entails a variation on the route of these services, leading to a greater overlap with route 57/58 and, as a result, represents expansion against the parties' services and a willingness to increase services in competition with the parties. Further, Johnson's stated that [ ]. The combined frequency of the new 150 services and the remaining X50 services is broadly the same as the former X50 frequency.

### **Conclusion on entry and expansion**

106. The OFT recognises that the local market appears to be characterised by a degree of entry and expansion and notes the specific instances of entry and expansion recently and in the past. However, taking account of all of the evidence available to it, the OFT does not consider that actual entry would be timely, likely or sufficient in scope to prevent a substantial lessening of competition from arising as a result of the merger. The OFT also recognises that in this case the prevalence of dynamic supply-side responses and bus operators may create a perceived constraint through the threat of entry or expansion, but does not consider that the evidence points to this perceived potential competitive threat being sufficient to allay its concerns in this case.

## **THIRD PARTY VIEWS**

107. Specific third party views have been discussed above where relevant. The vast majority of competitors contacted by the OFT indicated that the merger would lead to either a reduction or an elimination of competition in the Redditch area. Several bus users have expressed concerns about the deterioration of bus services in Redditch following the merger. One bus user noted that some limited improvements to the quality of ex-First R&K services were made in Kidderminster following the merger.

## **ASSESSMENT**

108. The OFT believes that it is or may be the case that the merger has resulted in a relevant merger situation on the basis that the parties have a combined share of local bus services in Worcestershire, on the basis of passenger journeys originated in Worcestershire (boardings) greater than 25 per cent, with an increment attributable to the merger.

109. Based on the evidence available, the OFT cannot exclude as unrealistic the prospect that the First R&K business could have continued operating absent the merger or a sale to an alternative purchaser. The OFT therefore adopts prevailing competitive conditions as the counterfactual against which to assess the merger.
110. The OFT considers that the appropriate frames of reference for consideration are: (a) local bus services (commercial and tendered) on overlapping flows; (b) local bus services in Redditch at a network level; and (c) competition for tender contracts in Redditch.
111. The OFT has identified competition concerns in relation to the supply of local bus services in individual overlap flows in Redditch, including route 57/58, the Redditch to Batchley flow and the Redditch to Crabbs Cross flow, where, on the basis of the evidence available to it, the OFT considers that the merger raises unilateral horizontal competition concerns.
112. The OFT has also identified competition concerns in the provision of tendered bus services, especially in relation to tenders for local bus services in Redditch, where it also considers, on the basis of the evidence available to it, that the merger raises unilateral horizontal competition concerns.
113. The OFT has not seen evidence to indicate that there is a sufficient constraint from the threat of entry or expansion by other operators on these flows and in competition for tendered contracts to prevent competition concerns from arising.
114. The OFT has left open the question of whether the test for reference is met in relation to the parties' overlap at network level in Redditch, as determination of this would not change the OFT's conclusion in this case.
115. Consequently, the OFT believes that it is or may be the case that the merger has resulted or 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

116. The OFT has found a realistic prospect of a substantial lessening of competition in relation to the supply of bus services in Redditch, as outlined above. The OFT's duty to refer is therefore met in this case. The duty to refer under section 22(1) of the Act is subject to certain discretionary exceptions under section 22(2) of the Act, including any relevant customer benefits and if the markets concerned are not of insufficient importance to justify a reference (the 'de minimis' exception). These are considered below.

### Relevant customer benefits

117. Under section 22(2)(b) of the Act, the OFT may decide not to make a reference where it believes that any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition concerned.

118. Section 30 of the Act defines such benefits as including lower prices, higher quality, greater choice or greater innovation.

119. Rotala submits that the merger would give rise to customer benefits by providing a wider network throughout Redditch to Rotala multi-journey ticket holders, a reduction of waiting times through a better coordination of services, the introduction of DDA compliant vehicles, and the reduction of safety issues through the reduction of the number of overtaking buses in route 57/58.

120. The OFT requires detailed and verifiable evidence that benefits will accrue to customers.<sup>46</sup> However, no such evidence has been produced in this case. In addition, some of the claimed benefits (notably the reduction of waiting times) are inconsistent with the expected market outcomes given the OFT's finding on the likely loss of competition arising from the merger. Furthermore, the parties have not submitted evidence to demonstrate that the benefits could not be obtained in the absence of the merger.<sup>47</sup>

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<sup>46</sup> See *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference*, OFT1122, paragraph 4.9.

<sup>47</sup> *Ibid.*, paragraph 4.7.

121. Therefore, the OFT does not consider it appropriate to exercise its discretion not to refer the merger on the basis of customer benefits.

### **The 'de minimis' exception**

122. In deciding whether or not to apply the 'de minimis' exception, the OFT will exercise its discretion, taking account of the facts of each individual case and its circumstances and having regard to its guidance and decisional practice in the area.

123. In considering this discretion, the OFT will assess whether the benefit of a reference to the CC (in terms of the potential consumer harm saved) is materially greater than the average public cost of such reference.<sup>48</sup>

### **Whether undertakings are available**

124. The OFT generally will not apply the 'de minimis' exception where clear-cut undertakings in lieu of reference could be offered by the parties to resolve the competition concerns identified. The OFT's judgment in this respect is an 'in principle' one that does not depend on any actual offer of undertakings in lieu.<sup>49</sup> The OFT is generally unlikely to consider behavioural undertakings to be sufficiently clear-cut to address competition concerns in view of the risks as regards, for example, monitoring and enforceability.<sup>50</sup> Further, the OFT will not consider that undertakings in lieu are in principle available where the OFT's competition concerns relate to such an integral part of the transaction that to remedy them through structural divestment would be tantamount to prohibiting the merger altogether.<sup>51</sup>

125. In this case, the OFT considers that, given the competition concerns relate to multiple routes – which together represent a substantial proportion of the total revenue of First R&K – and potentially the need for a depot and buses to operate on those routes, a clear-cut remedy would involve divesting such a substantial proportion of the acquired business that this would be tantamount to prohibiting the transaction, any undertaking by Rotala that remedies the competition concerns identified would be

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<sup>48</sup> *Ibid.*, paragraph 2.11.

<sup>49</sup> *Ibid.*, paragraphs 2.18 to 2.27.

<sup>50</sup> *Ibid.*, paragraph 5.39.

<sup>51</sup> *Ibid.*, paragraph 2.25.

tantamount to prohibiting the deal. The OFT therefore does not consider that undertakings in lieu of a reference are in principle available in this case.

### **Application of the 'de minimis' exception to this case**

126. The OFT estimates the affected markets in this case are worth approximately £[2-3] million if the revenues on the 57/58 route, the Redditch to Batchley flow and the Redditch to Crabbs Cross flow, as well as the annualised value of the contracts won by Rotala and First R&K with WCC in Redditch are taken into account. This market size is well below the £10 million threshold above which the 'de minimis' exception will not be applicable. It is also below £3 million for which a reference to the CC would generally not be justified.

127. The OFT would expect to refer a merger where the value of the market(s) concerned was less than £3 million only exceptionally, and where the direct impact of the merger in terms of customer harm was particularly significant and/or where that merger was highly replicable in the relevant sector.<sup>52</sup> The OFT is also mindful of the CC's recommendation in its local bus market report to consider a lower market size threshold than £3 million for bus mergers.<sup>53</sup> As a result, the OFT has considered carefully whether it is appropriate for the 'de minimis' exception to be applied in this case. In its assessment of this, the OFT has considered, alongside the market size, the interaction between the strength of the concerns, the magnitude of competition lost by the merger, and the durability of the merger's impact, as well as the wider implications of any decision for its treatment of future cases.

### **Strength of the OFT's concerns**

128. The OFT's strongest concerns relate to routes 57/58, which accounts for revenues of [].

129. On this route, the local conditions of competition appear to be characterised by a threat of entry and expansion. Events that have occurred since the merger illustrate this dynamic competition, with a strong

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<sup>52</sup> *Ibid.*, paragraph 2.15.

<sup>53</sup> CC, Local bus services market report, paragraph 15.357.

possibility of supply-side responses – and the potential threat for supply-side responses to occur – as a constraint on Rotala’s activity in the area. Expansion has taken place since the merger and notification of entry has taken place, both in relation to the 57/58 route. While neither of these events are independently nor together sufficient to allay competition concerns on the route (or any other routes), they are indicative of the limited likelihood that sustained harm may arise, not merely through the potential for actual entry or expansion to take place but as indicative of the potential for supply-side responses and thus act as a signal of the perceived potential threat faced.

130. Further, specifically on the routes from Redditch town centre to Batchley and from Redditch town centre to Crabbs Cross, the strength of the OFT’s concerns in respect of these routes are relatively less, given the extent of the competition between Rotala and First pre-merger. In particular:

- On Redditch town centre to Batchley, the parties’ services on route 51 run at different frequencies, one being twice as frequent as the other. Moreover, First R&K’s service 51 runs six times more frequently than Rotala’s service 50.
- On the Redditch town centre to Crabbs Cross flow, the parties do not overlap on the entire route (see above). The parties’ services operate at different frequencies and can take longer on a point-to-point basis, depending on where passengers catch the bus and their choice of alternative stops on each of the routes. Moreover, Stagecoach may provide a limited constraint along some sections of the route through service 26.

131. Likewise, in relation to tenders, the OFT considers that the options for further tenders from smaller operators are possible.

132. The OFT therefore considers that, while the realistic prospect of a substantial lessening of competition standard has been met in this case, the strength of its concerns is lessened by the above factors.

### **The magnitude of competition lost**

133. The OFT considers that the lessening of competition in this case is substantial in scale (as the test for reference is met). However, the extent

of any price effect may be limited by the actual and perceived threat of supply-side responses (see above). The OFT considers that these factors – although insufficient to prevent a realistic prospect of an SLC – should serve to constrain the extent of that SLC and serve as some disciplining mechanism on Rotala post-merger that limits the effects of the reduction in competition.

134. Further, specifically on the routes from Redditch town centre to Batchley and from Redditch town centre to Crabbs Cross, the magnitude of any price rise following the Transaction may be more limited, given the extent of the competition between Rotala and First pre-merger outlined above.

### **Durability of harm**

135. The OFT is mindful of the CC's conclusions regarding bus operators' unwillingness to engage in head-to-head competition. While this was confirmed by some third parties during the OFT investigation in this case, the active entry and expansion activity that has taken place may point against this being a relevant factor in this particular case, for example, the entry of Rotala against First in this area is a case in point. The OFT considers that the limited evidence of dynamic supply-side responses that characterise this local area may point to reducing durability of any harm.

### **Replicability**

136. The OFT is mindful of the risk that using the exception in this case would create an expectation that similar mergers would also be cleared. In its local bus services report, the CC recommended that the OFT exercise caution when using the 'de minimis' exception in bus cases in particular given the risk that this creates an expectation that future small anti-competitive mergers would be cleared.<sup>54</sup> The OFT has taken account of the wider policy implications in its assessment of the extent to which a reference would be justified in this case and considers that, even taking account of this, a reference to the CC would not be justified.

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<sup>54</sup> CC, Local bus services report, paragraph 15.357.

### Conclusion on 'de minimis'

137. The OFT has carefully considered whether the exercise of its '*de minimis*' discretion should be applied in this case. It considers that the balance of factors set out above is in favour of the exercise of its discretion. The OFT therefore considers that, to the extent that the duty to refer may be met, it would be appropriate to exercise it '*de minimis*' discretion in this case.

### DECISION

138. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.

### END NOTES

1. For clarity, the OFT notes that the customary provision 'subject to contract' applied during the time period stated in paragraphs 63 and 64. This does not change the reasoning of the decision.
2. For clarity, the last sentence in paragraph 135 should read: '[t]he OFT considers that, [though] limited, the evidence of dynamic supply-side responses that characterise this local area may point to reducing durability of any harm.' This minor typographical amendment does not change the reasoning of the decision.