
Anticipated acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon And Cornwall Limited

ME/5435-12

The OFT's decision on reference under section 33(1) given on 10 July 2012. Full text of decision published 28 August 2012.

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. **Stagecoach Group plc** (Stagecoach) operates registered local bus services of a commercial and tendered nature. In the year ended 30 April 2011 Stagecoach earned revenue of £2.4 billion, most of which was derived from its UK operations. Stagecoach's UK bus division operates approximately 7,700 vehicles from over 100 depots. Stagecoach also operates various rail franchises in the UK.
2. **First Devon and Cornwall Limited** (First) is a wholly owned subsidiary of FirstGroup PLC. The business which is the subject of the transaction (the North Devon Business) operates local bus services of a commercial and tendered nature. The North Devon Business earned revenue of £[] million in the year ended 31 March 2011, all of which was earned in the UK.

TRANSACTION

3. On 9 March 2012, Stagecoach (through its wholly owned subsidiary, Stagecoach Devon Limited) and First signed a business sale agreement under which Stagecoach would purchase First's North

Devon assets and business. These assets include 34 vehicles, 95 employees and a bus depot in Barnstaple. The consideration is £[] million (subject to various adjustments). Completion of the transaction is conditional upon OFT clearance.

JURISDICTION

4. The OFT considers that the transaction would result in two or more enterprises ceasing to be distinct.
5. In the year ended 31 March 2011, the North Devon Business earned revenues of £[] million. Therefore, the turnover test contained in section 23(1)(b) of the Enterprise Act 2002 (the Act) is not satisfied.¹
6. The parties overlap in the provision of local bus services in the local authority areas of North Devon and Torridge, and the town of Bude in Cornwall. For jurisdictional purposes the OFT considers the local authority areas of North Devon and Torridge as the geographic extent of the relevant area in which it is reasonable to apply the share of supply test (the relevant area).
7. Stagecoach queries whether the relevant area² constitutes a 'substantial part of the UK', for the purposes of the share of supply test under section 23(4) of the Act.
8. The OFT has considered the definition of a 'substantial part of the UK' given by the House of Lords in *R v Monopolies and Mergers Commission* and another, *ex parte South Yorkshire Transport Limited* ('*ex parte South Yorkshire*'), which involved the merger of two local bus companies in South Yorkshire. The House of Lords considered that the definition of a 'substantial part of the UK' required that an area or areas must be considered of such size, character and

¹ The transaction is not subject to EU Council Regulation 139/2004 because the turnover thresholds are not satisfied.

² Stagecoach considered that the relevant area could reasonably also include the town of Bude in Cornwall.

importance as to make it worth consideration for the purposes of merger control.³

9. The OFT notes that in the *Stagecoach/Preston Bus* case, the OFT and Competition Commission (CC) both found that a population of 131,000 and a geographic area of approximately 144 square kilometres were sufficient to constitute a substantial part of the UK.⁴
10. In the context of the current transaction, the OFT notes that the population of the relevant area and its geographic extent exceed that of Preston. The relevant area has a population of around 157,300⁵ and the geographic coverage of the area is around 2,080 square kilometres.⁶
11. Furthermore, the OFT considers that the character and importance of the relevant area make it worthy of consideration for the purposes of the Act. The area includes the town of Barnstaple, which is the main urban centre in North Devon and contains a district hospital and a large further education college. The area also has a significant tourism industry, attracting a large number of visitors each year.
12. The OFT therefore considers the area to be sufficient to constitute a 'substantial part of the UK' for the purposes of the share of supply test under section 23(4) of the Act in this case.

³ In that case, Lord Mustill stated that: '...where the task is to interpret an enabling provision, designed to confer on the commission the power to investigate mergers believed to be against the public interest the court should lean against an interpretation which would give the commission jurisdiction over references of the present kind in only a small minority of cases. This is the more so in the particular context of local bus services, since the provision of adequate services is a matter of importance to the public, as witness the need felt by Parliament to make special provision for them in the Transport Act 1985' [1993] 1 ALL ER 289.

⁴ OFT decision, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 28 May 2009, paragraphs 8 to 11, and CC report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009, paragraphs 3.11 to 3.14.

⁵ Devon County Council.

⁶ Devon County Council.

13. The parties are both active in the supply of local bus services in the relevant area. The parties have been unable to provide precise share of supply data for the relevant area. However, Stagecoach pointed to the CC local bus services report⁷ which included data indicating that the parties' combined share of supply of local bus services in North Devon (an area which substantially overlaps with the relevant area in this case) was 78.7 per cent. Stagecoach does not dispute that the combined share of supply in the relevant area (to the extent it does qualify as a substantial part of the UK) would exceed 25 per cent.
14. The OFT therefore considers that the merger qualifies for investigation on the share of supply test, with the parties together supplying more than 25 per cent of local bus services in the local authority areas of North Devon and Torridge. Consequently, the share of supply test in section 23(4) of the Act is satisfied.

BACKGROUND

15. The OFT and CC have each considered local bus service mergers on a number of occasions.⁸ In addition, on 7 January 2010, the OFT referred the supply of local bus services to the CC for investigation and report.⁹ On 20 December 2011, the CC published the results of its local bus services market investigation.¹⁰ The report concludes,

⁷ 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.

⁸ For example, OFT decision acquisition by Stagecoach of Eastbourne Buses and Cavendish Motor Services, 13 May 2009, CC report completed acquisition by Stagecoach Group Plc of Eastbourne Buses Ltd and Cavendish Motor Services Ltd, 22 October 2009, OFT decision acquisition by Go-Ahead plc of Arriva plc's (West Sussex) business, 16 November 2009, and OFT decision acquisition by McGill's Bus Services Limited of the Arriva Scotland West local bus business, 18 April 2012.

⁹ www.offt.gov.uk/OFTwork/markets-work/references/bus-services.

¹⁰ CC, 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.

inter alia, that, '[...] ongoing sustained head-to-head competition, where present, delivers significant benefits to customers.'¹¹

COUNTERFACTUAL

16. The parties submit that prevailing conditions do not represent the appropriate counterfactual against which to assess the transaction. In particular, First submits that, due to the poor financial performance of the North Devon Business, it will exit the supply of bus services in North Devon¹² absent the merger. Therefore, First submits that the appropriate counterfactual is a scenario whereby First would exit the North Devon bus service market and Stagecoach would not face competition from First or from an alternative purchaser of the North Devon Business.

OFT assessment of appropriate counterfactual

17. The OFT's approach to the appropriate counterfactual is outlined in section 4.3 of the Merger Assessment Guidelines. The OFT considers the effect of the merger against the most competitive counterfactual (provided that situation is realistic). In practice, the OFT generally adopts the prevailing conditions of competition as the counterfactual.¹³

18. In the context of an exiting firm (or an exiting division of a firm) scenario, the OFT has stated that it will only depart from the prevailing conditions as the appropriate counterfactual if it:

- believes (on the basis of compelling evidence) that it is inevitable that the firm would exit the market

¹¹ CC Local bus services report, paragraph 2.

¹² In the remainder of the decision 'North Devon' is used to include the local authority areas of North Devon and Torridge and the town of Bude in Cornwall.

¹³ OFT/CC Joint Merger Assessment Guidelines, paragraph 4.3.5.

- is confident that there is no substantially less anti-competitive purchaser for the firm or its assets, and
- believes that the exit of the firm and its assets would not be 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).¹⁴

19. Where the OFT is unable to reach a sufficient level of confidence on each of the above considerations, it will use the prevailing competitive conditions as the relevant counterfactual.¹⁵

Inevitable exit

20. First submits that the North Devon Business began suffering losses in [] and has continued to be loss-making. Furthermore, First submits that the impending reduction of the bus service operators grant, changes to concessionary fare schemes and the increasing cost of fuel are all projected to impact negatively on the North Devon Business, leading to even greater losses in the future.
21. First lost a significant number of tenders (and associated revenue) around the time Stagecoach entered North Devon in 2006. A significant number of contracts were re-tendered by Devon County Council in 2011. First has provided internal documents from 2010 and 2011 indicating an intention to close or dispose of the North Devon Business unless it won a significant number of the 2011 tenders. In the event, First won only one of 19 tenders. First submits that, following this failure to win significant new tenders, it was inevitable that it would exit North Devon through either disposal or closure of the North Devon Business. First submits that this is consistent with its current strategic focus, which includes disposing of loss-making bus operations.

¹⁴ OFT/CC Joint Merger Assessment Guidelines, paragraph 4.3.8 to 4.3.10.

¹⁵ OFT/CC Joint Merger Assessment Guidelines, paragraph 4.3.10.

22. The OFT's analysis of First's accounts indicated that the North Devon Business made an operating loss (after overheads) in [] of its last [] years of operation. In order to assess whether it would be profit-maximising to close the North Devon Business, the OFT sought to distinguish those overheads that could be avoided in the event of closure from those overheads that would continue to be incurred despite closure. This analysis indicated that, in its most recent financial year, the North Devon Business was not covering those overheads that could be avoided in the event of closure. Therefore, the OFT concluded that First would make a net saving by closing the North Devon Business.
23. The OFT undertook a detailed examination of First's internal strategy documents in relation to the North Devon Business. The documents tend to support First's submission that it had since 2010 intended to exit North Devon unless it won significant new tender contracts in 2011.
24. Furthermore, First's actions in other areas are consistent with its submission that it had no strategy that would have led it to continue operating the North Devon Business notwithstanding its poor financial performance. An internal document from []¹⁶ indicated that First's bus operations in [] areas (including North Devon) would be closed or sold as part of a rationalisation process. Aside from North Devon, one of these operations has now been closed (East and Mid Lothian), two have been sold (Kings Lynn and East London) and First informs the OFT that it is close to agreeing the sale of its business in the fourth area ([]).¹⁷
25. Accordingly, the OFT considers that the balance of the evidence supports First's argument that it would have exited the North Devon area absent the merger. However, given the OFT's findings on the potential for alternative purchasers for the North Devon Business, it

¹⁶ First Counterfactual Paper, Annex 8.

¹⁷ First also closed another loss-making business (Bury St Edmunds) in 2012.

is not necessary to conclude on whether exit would have been inevitable.

Substantially less anti-competitive purchaser

26. First accepted that it did not market the North Devon Business to anyone other than Stagecoach. The lack of a thorough and open marketing process makes it difficult, from an evidential perspective, for the OFT to reach a view that there is no prospect of a substantially less anti-competitive purchaser for a business. Without such marketing, it is generally difficult for the OFT to have the requisite degree of confidence that no alternative purchaser would have emerged absent the merger.
27. First submits that no bus operator other than Stagecoach would have been interested in acquiring the North Devon Business, given its financial condition. It submits that Stagecoach was uniquely placed to realise synergies from acquiring the North Devon Business. Hence, First argued that it did not market the North Devon Business because it was aware that Stagecoach was the only commercially feasible purchaser.
28. However, three bus operators in the region informed the OFT in its market testing that they might have been interested in acquiring the whole or part of the North Devon Business had they been offered the opportunity of doing so. These expressions of interest cast doubt on First's submission that it is abundantly clear that no one else would have wished to acquire the North Devon Business. Each of these three operators has very limited overlaps with the North Devon Business (in contrast to Stagecoach's own position). Accordingly, the OFT considers that any of these operators would have been a substantially less anti-competitive purchaser than Stagecoach.
29. First submitted that, notwithstanding the expressions of potential interest, it was unrealistic to expect that any bus operator in the region (other than Stagecoach) would have acquired the North Devon Business. In particular, First queried whether any of the third parties who expressed an interest would have had the financial capacity and incentive to purchase the North Devon Business given the liquidation value of the assets and its loss-making condition.

30. The OFT's ability to test the ability and incentive of these third parties to purchase the North Devon Business was limited by the fact that the third parties have not had any opportunity to conduct due diligence and thus did not have full information on the business.
31. The OFT does not have detailed information on the financial capacity of each of the third parties that expressed some potential interest. However, taking number of vehicles as a proxy for the size of the business, each of those third party's fleets was larger than the North Devon Business's. Furthermore, one third party told the OFT that it would have access to acquisition funding in excess of the sum quoted by First as the liquidation value of the North Devon Business. Accordingly, the OFT is unable to conclude that the third parties that expressed an interest would not have had sufficient financial capacity to acquire whole or part of the North Devon Business.
32. The OFT was also unable to conclude that none of the third parties would have the incentive to acquire the North Devon Business. Each of the three operators told the OFT that they might have been interested in acquiring the whole or part of the North Devon Business. One third party that expressed an interest appeared to be an especially credible potential purchaser given the size of its business. First stated that it believed that third party operator would not in fact be interested in acquiring the North Devon Business because the workforce is largely unionised. First supported this submission with a witness statement recollecting a conversation between First and the third party in respect of an earlier opportunity to acquire First's business in []. First's witness's recollection was that one of the reasons the third party was not interested in the [] acquisition was that the relevant business had a unionised workforce. First inferred from this that the third party would not be interested in acquiring the North Devon Business.
33. The OFT has not found it necessary to reach a finding of fact in respect of whether unionisation of the workforce was discussed in conversations between the two companies. However, regardless of the content of those conversations, the third party stated that unionisation of the workforce had not been the primary reason for its lack of interest in First's Plymouth business. The third party stated

that the primary reason for its lack of interest was that []. The third party stated that it might have been interested in acquiring the North Devon Business notwithstanding the unionisation of the workforce.

34. The OFT has considered the evidence put forward by First carefully in determining whether there is a realistic prospect that the North Devon Business would have been sold to a substantially less anti-competitive purchaser absent the sale to Stagecoach. The OFT accepts that it is uncertain whether any of the three third parties discussed above would in fact have made an offer above liquidation value in the event that they had been given the opportunity to do so following a suitable period of due diligence. However, no third party other than the major competitor in the area, Stagecoach, was provided with the opportunity to bid for the business. As such, the OFT must operate with appropriate caution in assessing the evidence before it in this case. The balance of the evidence in front of the OFT does not allow it to conclude with confidence that the prospect of such an alternative offer can be dismissed. Accordingly, the OFT is unable to conclude that the North Devon Business could not have been sold to a substantially less anti-competitive purchaser absent the merger.

Exit substantially less anti-competitive

35. In light of the OFT's findings on the prospect for substantially less anti-competitive purchasers, it is not necessary to consider whether exit would be substantially less anti-competitive than the merger.

Conclusion on counterfactual

36. Since the OFT is unable to conclude that there would not have been a substantially less anti-competitive purchaser for the North Devon Business absent the merger, it has adopted prevailing competitive conditions as the appropriate counterfactual for assessing the transaction.

FRAME OF REFERENCE

37. The parties overlap in the provision of local bus services (commercial and tendered) and competition for tender contracts in North Devon.

Product scope

Commercial bus services and competition for tenders

38. Stagecoach submits that there are separate markets for the provision of commercial bus services and the right to operate tendered services.
39. This is consistent with previous OFT and CC decisions¹⁸ and with the CC's local bus market report which concluded that competition for tenders should be analysed separately from the provision of local bus services, while taking into account that there may be some linkages between commercial and tendered services.¹⁹
40. The OFT's market investigation has not uncovered any evidence that contradicts this analysis. Therefore, the OFT assesses competition for tender contracts separately from the provision of commercial bus services, while taking into account that there may be some linkages between the commercial and tendered businesses.

Commercial bus services and tendered bus services

41. 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

¹⁸ See for example, OFT decision anticipated acquisition by Arriva Northumbria Limited of the bus operations of Go North East Limited in Ashington, Northumberland, 11 February 2010, OFT decision anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited, 23 December 2009, CC Report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009.

¹⁹ CC, Local bus services report, paragraph 7.120.

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.'²⁰

42. Stagecoach submits that tendered services do not compete with overlapping commercial services or other tendered services on the basis of price and/or frequency, as these parameters are determined by the local authority and there is no scope for short-term supply-side substitution of buses to or away from tendered services to compete with other tendered or commercial services.
43. 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.²¹
44. The OFT accepts that supply-side factors may affect the competitive dynamic between overlapping commercial and tendered services. 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 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.
45. This approach to the frame of reference is consistent with the OFT's approach to overlapping commercial and tendered services in Go-Ahead/Arriva Horsham where it stated that:

'Given these contractual conditions (governing service levels, frequency and fares), tendered services generally do not compete

²⁰ CC, Local bus services report, paragraph 7.114.

²¹ OFT/CC Merger Assessment Guidelines, paragraph 5.2.6.

with overlapping commercial services on the basis of these parameters (suggesting that a competitive assessment should analyse these separately). Notwithstanding this, in Horsham there are limited instances where passengers do have a choice between a commercial and tendered service. In such cases the two types of service are likely to be substitutes from the passengers' perspective (suggesting that a competitive assessment should analyse each together on a cautious basis).²²

Other forms of transportation

46. 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'.²³

47. In the current case some local bus operators have stated that the car does provide a viable alternative to local bus services for some

²² OFT decision, completed acquisition by Go-Ahead Group plc of Arriva plc's Horsham (West Sussex) business, 16 November 2009.

²³ CC, Local bus services report, paragraph 20 to 21 and paragraph 6.144 ff. The CC did note that competition from fixed modes of transport, such as rail or tram services, may provide an effective competitive constraint – see paragraph 7.52 to paragraph 7.63. Fixed modes of transport are not relevant in this case.

customers. However, one operator stated that most of its customers do not have access to alternative forms of transport.

48. The OFT has not received sufficient evidence to conclude 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. Therefore, the OFT considers that the frame of reference should not include forms of transport other than local bus services.

Geographic scope

Flow level

49. 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. 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.²⁴

Network level

50. Consistent with previous cases,²⁵ 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.
51. 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

²⁴ CC Report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009.

²⁵ OFT decision, acquisition by McGill's Bus Services Limited of the Arriva Scotland West local bus business, 18 April 2012.

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.

52. Stagecoach and the North Devon Business overlap in the supply of bus services in North Devon. The OFT therefore considers it appropriate to assess the merger in relation to the supply of bus services in North Devon, as well as assessing specific flow-by-flow overlaps.

Competition for tender contracts

53. 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.²⁶ This is consistent with the CC's local bus market report which found that the market for tenders will generally include all bus operators in the local area. Accordingly, the OFT considers that the geographic frame of reference for competition for tenders includes at least North Devon, and may include neighbouring areas.

Conclusion

54. The OFT considers that the relevant frames of reference for consideration are:
- local bus services (commercial and tendered) on overlapping flows
 - competition for tender contracts in the North Devon area, and
 - local bus services in North Devon at a network level.

²⁶ OFT decision, anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited, 23 December 2009.

COMPETITIVE ASSESSMENT – UNILATERAL EFFECTS

Overlap flows

Background

55. The OFT received substantial evidence that the parties have been competing intensely on several overlap flows since Stagecoach commenced operations in North Devon in 2006. In particular:

- several internal documents from the parties indicate intense competition between the parties and a First internal document describes improvements to First's frequencies and vehicle quality as a result of competition from Stagecoach²⁷
- a travel user group stated that bus users have benefitted from lower fares and higher frequencies on three route corridors since Stagecoach began competing with First, and
- a local authority stated its perception that competition had resulted in lower fares in North Devon than other parts of Devon.

56. The CC local bus market report includes a case study on North Devon. The case study describes, inter alia, head-to-head competition between Stagecoach and First on the Barnstaple to Bideford corridor.²⁸

Summary of overlap flows

57. The parties' bus services overlap on three route corridors, one further flow, and there are intra-urban overlaps on a number of services within Barnstaple, Ilfracombe and Bideford. This is summarised in Table 1 below.

²⁷ First Counterfactual Paper, Annex 2.

²⁸ CC, Local bus services report, Appendix 6.4.

Table 1 Summary of overlaps²⁹

Overlaps
Barnstaple-Ilfracombe
Barnstaple-Bideford/Westward Ho!/Appledore
Barnstaple-South Molton ³⁰
Bude-Stratton
Intra-Barnstaple
Intra-Ilfracombe
Intra-Bideford

Source: the parties, OFT analysis.

58. Individual overlap flows are discussed in greater detail below.

Filtering approach

59. Transport inquiries can involve a large number of overlap flows. In order to focus the analysis on those areas that are most likely to give rise to competition concerns, the CC developed a filtering approach to the overlaps in order to screen out overlap flows that are unlikely to be considered problematic. The CC sets out the following three filters:

- the relative importance of overlapping flows: the CC has in many cases chosen to exclude from initial analysis those routes for which overlaps account for less than 10 per cent of passengers and revenue,
- countervailing competition: the CC has considered that flows that are the subject of effective countervailing competition from third parties could be filtered out of the analysis. The appropriate definition of an effective competitor differs

²⁹ In 2011 the parties also overlapped on the flow between Barnstaple and Croyde but First provided evidence that its service was discontinued in August 2011 independently of the merger such that the overlap no longer arises.

³⁰ The parties' services between Barnstaple and South Molton overlap on two different routes between the towns.

depending on the geographic characteristics of the flows or routes. The CC has suggested frequency filters to indicate whether a bus operator's services are likely to constitute an effective competitive constraint, and³¹

- de minimis: the CC has indicated that flows of relatively little importance, in terms of either revenue, number of passengers or frequency of service, can also potentially be excluded from the initial stages of analysis.³²

60. In this case there are several overlap flows that are not excluded from consideration by any of the above filters. Stagecoach nonetheless submits that some of the parties' individual services on these flows should be excluded from consideration by application of filters. In particular, Stagecoach submits that certain individual services should be excluded from consideration on the basis that:

- a service's frequency on the overlap flow relative to the other party's services indicates that that service is not an effective competitor to the other party, and/or
- a service's revenue on the overlap flow is less than 10 per cent of total route revenue.

61. The OFT considers that the primary value of the filters is to identify overlaps that are worthy of initial consideration, especially in cases where there are a large number of overlaps. The OFT does not consider that it is necessary in a first phase review to use filters to exclude from the competitive assessment individual services on overlap flows that are already subject to substantive assessment (by virtue of overlaps between the merging parties' other services). In particular, once an overlap flow is subject to competitive assessment, the OFT's assessment will generally consider each of

³¹ See Appendix I of CC Report, Completed acquisition by Stagecoach Group Plc of Eastbourne Buses Limited and Cavendish Motor Services Limited, October 2009.

³² CC, Review of methodologies in transport enquiries, 2006, paragraphs 25 to 29.

the parties' services that provides a demand-side alternative on the relevant flow.

62. Furthermore, as regards frequency, when assessing whether two operators are effective competitors to one another on an overlap flow, the OFT considers that it is more relevant to consider the combined frequency of their services on that flow as opposed to the frequency of individual services.³³
63. In any event, as noted in previous cases,³⁴ these filters should not be viewed as safe harbours and, in particular where a transaction results in only one effective competitor on a given flow, as is the case on several flows in the current transaction, further analysis may be required.
64. Accordingly, while the OFT has had regard to the substantive reasoning underpinning the filters, it has not used a rigid application of the filters to exclude overlaps or individual services from its competitive assessment.

Barnstaple – Ilfracombe

65. Ilfracombe is a town approximately nine miles north of Barnstaple.
66. The Stagecoach services are:
 - service 21A which operates between Barnstaple and Ilfracombe via Braunton (the main Barnstaple to Ilfracombe corridor). This is a commercial service. It operates two services/hour during the weekday peak

³³ This is consistent with CC practice. See Appendix I, Completed acquisition by Stagecoach Group Plc of Eastbourne Buses Limited and Cavendish Motor Services Limited, October 2009.

³⁴ OFT decision, completed acquisition by Stagecoach Group plc of Preston Bus, 28 May 2009, paragraph 15.

- service 308 which overlaps on the main Barnstaple to Ilfracombe corridor on the section between Barnstaple and Braunton (before continuing to Croyde). This is a predominantly commercial service.³⁵ The service operates around two services/hour on weekdays, and
- service B1 which overlaps on the main Barnstaple to Ilfracombe corridor on the section between Braunton and Barnstaple. This is a tendered service. It is operated on a gross contract basis, Stagecoach is paid a fee to operate the service and does not retain any fare revenue. The service operates only in the summer and operates three services per day. It is specifically aimed at the tourist trade. The service will terminate at the end of summer 2012 when the funding expires.

67. The First services are:

- service 3 which operates between Barnstaple and Ilfracombe on the main corridor. This is a predominantly commercial service.³⁶ It operates around four services/hour during the weekday peak
- service 31 which operates on the main Barnstaple to Ilfracombe corridor on the section between Ilfracombe and Mullacott Cross (before continuing to Woolacombe). This is a tendered service. It operates hourly during the day, and
- service 30C which operates between Barnstaple and Ilfracombe on college days. This is a commercial service. It operates on a different route to main corridor but its journey time between the towns is similar to the other services at around 45 minutes. The service operates once a day on college days.

68. Stagecoach concedes that there is a reviewable overlap between Stagecoach services 21A and 308 and First service 3 but submits

³⁵ It is tendered on summer Sunday services and on a short section between Croyde and the village of Georgham.

³⁶ Sunday evening services are tendered.

that the following services should be excluded from the assessment of this flow:

- Stagecoach service B1 (on the basis that revenue on the overlap is low, the service is specifically aimed at tourists and the service will be discontinued at the end of summer 2012)
- First service 31 (on the basis that the overlap accounts for a small portion of total route revenue), and
- First service 30C (on the basis that it is insufficiently frequent to compete with the Stagecoach services).

69. The OFT has excluded Stagecoach Service B1 from the assessment on the basis that it is operated on a gross tender contract. Fares, frequency and other quality parameters are stipulated in the tender contract and Stagecoach does not receive any revenue upside for attracting customers to the service. As a result, while it is not necessary to reach a conclusion on service B1, the OFT considers it unlikely that the merger would affect Stagecoach's incentives in respect of the service.³⁷

70. However, the OFT considers that First services 31 and 30C should not be excluded from the analysis. In particular, as outlined above, the OFT does not consider it appropriate to apply filters to exclude individual services on an overlap that is subject to competitive assessment. However, it is not necessary to conclude on this point since the exclusion of these services (and their revenue) does not affect the OFT's decision.

71. The OFT considers that the parties' services compete as regards:

³⁷ For the reasons outlined more fully below in respect of the Barnstaple to South Molton flow, the OFT does not consider it appropriate to exclude net (as opposed to gross) contract tenders from the competitive assessment given the different incentives that apply where the operator of the tendered service retains passenger revenue.

- end-to-end journeys between Barnstaple and Ilfracombe – where Stagecoach’s service 21A presents an alternative to First’s Services 3 and 30C, and
- journeys on the route of the main Barnstaple to Ilfracombe corridor where Stagecoach’s service 21A and service 308 present an alternative at various stages to First’s services 3 and 31.

72. The parties have not submitted that any other bus operator offers effective competing services.

73. Filers operates service 301 on the same route as First’s service 30C. Given its route, it does not present an alternative for the majority of customers travelling on the main Barnstaple to Ilfracombe corridor. In principle, the Filers’ service could offer passengers travelling end-to-end between Barnstaple and Ilfracombe an alternative to the parties’ services on the main corridor (or First’s service 30C on the same route). However, the OFT considers that this service is unlikely to be an effective competitive constraint to the parties’ services, even for end-to-end journeys between Barnstaple and Ilfracombe since:

- the Filers’ service operates hourly – compared to the four services/hour operated by First and the two services/hour operated by Stagecoach, and
- the Filers’ service uses a back road which limits type of vehicle that can be operated, such that capacity is lower than on the merging parties’ services.

74. Accordingly, the OFT considers that the merger reduces the number of effective competitors on the flows between Ilfracombe and Barnstaple from two to one.

75. Stagecoach concedes that the merger may have an effect on competition on this flow but submits that it would continue to be constrained by the threat of entry or expansion by third parties. However, the evidence available to the OFT suggests that entry or expansion is unlikely to mitigate the competition concerns arising

from the merger (see further barriers to entry and expansion at paragraphs 119 to 126 below).

76. Accordingly, the OFT has identified competition concerns in respect of the overlap flows between Barnstaple and Ilfracombe.

Barnstaple - Bideford/Westward Ho!/Appledore

77. Bideford is a town about eight miles south-west of Barnstaple. Each of the services discussed in this section travel between Barnstaple and Bideford. Some of the services continue to one or other of the villages of Westward Ho! and Appledore, which respectively lie north-west and north of Bideford.

78. The Stagecoach services are:

- services 21/21A both operate between Barnstaple and Bideford via the B3233 (the main Barnstaple to Bideford corridor). Outside Bideford the services diverge at Northam, with service 21 continuing to Westward Ho! and service 21A continuing to Appledore. These are commercial services. In combination the services operate around four services/hour during the peak between Barnstaple and Bideford. After Bideford each service operates two services/hour to Appledore and Westward Ho!, respectively
- service 315 operates between Barnstaple and Bideford on the main corridor (before continuing to Exeter). This is a partially commercial service.³⁸ It operates once every two hours during the day
- service 85 operates between Barnstaple and Bideford via the A39 (that is, a different route to the main corridor) before continuing to Holsworthy. This is a tendered service. It operates four times per day. While it takes a different route, the journey

³⁸ Some off-peak and Saturday services are tendered.

time between Barnstaple and Bideford is comparable to the main corridor services, and

- service 319 operates between Barnstaple and Bideford via the A39 (that is, a different route to the main corridor) before continuing to Hartland. This is a tendered service. It operates around once every two hours. The journey time between Barnstaple and Bideford is comparable to the main corridor services.

79. The First services are service 1 and service 2. Both services operate between Barnstaple and Bideford on the main corridor, service 1 then continues on to Westward Ho! and service 2 continues to Appledore. These are predominantly commercial services.³⁹ In combination these services operate up to six services/hour between Barnstaple and Bideford during the weekday peak.

80. Stagecoach concedes that there is a reviewable overlap between Stagecoach services 21/21A and First services 1 and 2 but submits that its services 85, 315 and 319 should be excluded from the assessment on the basis that they are each insufficiently frequent to compete with the First services. However, the OFT considers that these services should not be excluded from the analysis. In particular, as outlined above (see paragraphs 61ff), the OFT does not consider it appropriate to apply filters to exclude individual services on an overlap that is subject to competitive assessment. However, it is not necessary to conclude on this point since the exclusion of these services (and their revenue) does not affect the OFT's decision.

81. The OFT considers that the parties' services compete as regards:

- end-to-end journeys between Barnstaple and Bideford – where Stagecoach's services 21/21A, 85, 315 and 319 present alternatives to First's services 1 and 2, and

³⁹ Some evening services are tendered.

- journeys on the route of the main Barnstaple and Bideford corridor (and Appledore/Westward Ho!) where Stagecoach's services 21/21A present an alternative to First's services 1 and 2.
82. The parties have not submitted that any other bus operator offers competing services. Accordingly, the OFT considers that the merger reduces the number of effective competitors on flows between Barnstaple and Bideford from two to one.
83. Stagecoach accepts that the merger may have an effect on competition on this overlap but submits that it would continue to be constrained by the prospect of entry or expansion. However, the evidence available to the OFT suggests that entry or expansion is unlikely to mitigate the competition concerns arising from the merger (see further barriers to entry and expansion at paragraphs 119 to 126 below).
84. Furthermore, an internal document suggests that Stagecoach could reduce frequency on the main corridor post-merger.⁴⁰ This suggests that the constraint imposed by entry or expansion is unlikely to mitigate the competition concerns arising from the merger.
85. Accordingly, the OFT has identified competition concerns in respect of the flows between Barnstaple and Bideford/Westward Ho!/Appledore.

Barnstaple - South Molton

86. South Molton is a town around 11 miles to the south-east of Barnstaple. The parties' services overlap on two routes between Barnstaple and South Molton:
- via the A361, and

⁴⁰ Stagecoach Submission, Annex 11.

- via Swimbridge (a village between Barnstaple and South Molton).

87. The Stagecoach services are:

- service 155 operates between Barnstaple and South Molton before continuing to Exeter. Service 155 operates via the A361 and via Swimbridge. It is a tendered service between Barnstaple and Tiverton (thus including the whole of the Barnstaple to South Molton section) and is a commercial service for the remainder of the route. The 155 operates hourly in the day time peak. When operating via the A361 the journey time between Barnstaple and South Molton is around 20 minutes. When operating via Swimbridge the journey time is around 28 minutes, and
- service 307 operates between Barnstaple and South Molton via Swimbridge, continuing to Bampton. It is a tendered service and operates four services/day. The journey time between Barnstaple and South Molton is around 30 minutes.

88. The First services are:

- service X7 operates between Barnstaple and South Molton via the A361. It is a commercial service and operates hourly. The journey time between Barnstaple and South Molton is around 25 minutes, and
- service 5/5C operates on the Barnstaple to South Molton via Swimbridge. Most of the services operate only on the section between Barnstaple and Swimbridge, a number continue to South Molton. It is a commercial service that generally operates hourly on the section between Barnstaple and Swimbridge. The journey time between Barnstaple and South Molton is around 30 minutes.

89. Stagecoach submits that no competition concerns would arise for several reasons.

90. First, Stagecoach submits that Stagecoach service 155 and First service X7 do not compete because the services are different in nature, with Stagecoach service 155 serving more villages between Barnstaple and South Molton than First service X7. However, the journey times on service 155 are broadly comparable to service X7. Therefore, the OFT considers that it is reasonable to treat these services as demand-side alternatives on the overlap flows.
91. Second, Stagecoach submits that no competition concerns can arise from the overlap because the Stagecoach services are tendered such that, even if the parties' services are alternatives from a demand-side perspective, there is no scope for competitive harm to arise because the tender contract specifies the key parameters of competition (including fares, frequency and vehicle quality).
92. The OFT 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 will limit the merged entity's ability to deteriorate the offering of the tendered service.⁴¹ However, the OFT has been unable to exclude the prospect that combining these tendered and commercial services could result in competitive harm notwithstanding the constraints imposed by the tender contract through, for example, the following means:
- Pre-merger, passengers switching from the commercial services to the tendered services in response to a price increase or service degradation on the commercial services would result in lost revenue for First. Post-merger, Stagecoach would capture revenue diverted to the tendered service. The tendered services

⁴¹ The different nature of tendered services also means that, while merging a commercial and tendered service might result in competitive harm, a third party tendered service may not exert an effective competitive constraint on merging parties. For example, Devon County Council told the OFT that it generally sets minimum tender fares in line with commercial fares on overlapping flows. This policy would mean that a third party tender service is unlikely to exert an effective price constraint on an overlapping commercial service.

on this route are based on net tender contracts, meaning that the operator retains the fare revenue generated by attracting passengers. This may create an incentive to increase prices or degrade the quality of the commercial service. The incentive to increase prices would be even greater in the event that Devon County Council followed its general policy of increasing minimum tender fares in line with the increase in commercial fares on the overlapping flow.⁴²

- Pre-merger, passenger switching from the tendered services to the commercial services would result in lost revenue for Stagecoach. This may create an incentive to maintain quality, reliability and other service levels above the level required by the tender contract. Post-merger, the merged entity would capture revenue diverted to the commercial services. This may create an incentive to degrade the quality of the tendered service to the minimum required by the tender contract.
93. Stagecoach submits that it would not have an incentive to divert passengers away from commercial services given the risk that it may lose the tender contract in the future. However, it is not clear to the OFT that the potential future risk of losing the tendered service would be sufficient to negate the incentive to increase fares or reduce service quality on the commercial service.
94. Stagecoach submits that Devon County Council could take action to prevent the merged entity pursuing strategies that harmed consumers. However, it is not clear to the OFT that this oversight by the council would be sufficient to replicate the pre-merger competitive constraint between the parties to avoid any prospect of harm resulting from the loss of competition. For example, the council

⁴² Stagecoach submits that the council would be unlikely to follow its general policy in circumstances where it was increasing prices unjustifiably. However, in an environment where prices are changing in any event, and given the relatively small size of a bus fare in absolute terms, it is not clear to the OFT that a small but significant increase in commercial fares would be perceptible and regarded as sufficiently unjustified such that the council would dis-apply a general policy of tracking commercial fares.

would be unable to require the maintenance of service standards above those stipulated by the tender contract.

95. Thirdly, Stagecoach submits that Stagecoach service 307 and First service 5/5C should be excluded from the assessment on the basis that their frequency is insufficient to exert an effective competitive constraint. However, as outlined above (see paragraphs 61ff) the OFT does not consider it appropriate to apply filters to exclude individual services on an overlap that is subject to competitive assessment.
96. Accordingly, the OFT considers that the parties' services are likely to exert a competitive constraint on one another pre-merger. The OFT considers that parties' service compete as regards:
 - end-to-end journeys between Barnstaple and South Molton – with Stagecoach services 155 and 307 presenting alternatives to First's X7 and 5/5C (as regards the latter's services along the entire route between the towns)
 - journeys on the route between Barnstaple and South Molton via the A361 – with Stagecoach services 155 presenting an alternative to First's X7, and
 - journeys on the route between Barnstaple and South Molton via Swimbridge – with Stagecoach service 307 and 155 presenting an alternative to First's 5/5C.
97. The parties have not submitted that any other bus operator offers competing services. Accordingly, the OFT considers that the merger reduces the number of operators on the flows between Barnstaple and South Molton from two to one.
98. The evidence available to the OFT suggests that entry or expansion is unlikely to mitigate the competition concerns arising from the merger (see further barriers to entry and expansion at paragraphs 119 to 126 below).

99. Accordingly, the OFT has identified competition concerns in respect of the overlap flows between Barnstaple and South Molton.

Bude-Stratton

100. Bude is a town in North Cornwall. Stratton is a town around two miles east of Bude.

101. The relevant Stagecoach service is service 128. It is a tendered service operating within the towns of Bude and Stratton. It is operated on a gross contract basis, Stagecoach is paid a fee to operate the service and does not retain any fare revenue.

102. The relevant First service is service X9. It operates between Bude and Stratton before continuing to Exeter. It is a commercial service. The service operates once every two hours.

103. The OFT considers that the nature of Stagecoach service 128 means competition concerns are unlikely to arise in respect of this overlap. Fares, frequency and other quality parameters are stipulated in the tender contract and, unlike a net tender contract, Stagecoach does not receive any revenue upside for attracting customers to the service. As a result, the OFT considers it is unlikely that the merger would affect Stagecoach's incentives in respect of service 128.⁴³ However, it is not necessary to reach a conclusion on this overlap since it does not affect the OFT's decision.

Intra-Barnstaple

104. Stagecoach operates a series of tendered intra-urban services within Barnstaple, these overlap with one or more of the First services operating on the routes to Ilfracombe, Bideford/Westward Ho!/Appledore and South Molton.

⁴³ Stagecoach Service 85 operates on the overlap flow twice per day. However, since the overlap flow is not otherwise subject to substantive assessment, the OFT considers that the overlap with Service 85 is sufficiently small to not warrant further consideration: Service 85 revenue on the overlap in the past year was around £13.

105. The relevant overlaps are as follows:

- Stagecoach service 6: overlaps with First service 1, 2, 3 and 30C for around 2.3 km
- Stagecoach services 8/8A: overlap with First service 1 and 2 for around 2.3 km
- Stagecoach services 71/72: overlap with First service 1 and 2 for around 2.1 km
- Stagecoach service 12 overlaps with First service 1 and 2 for around 2.1 km
- Stagecoach service 9 overlaps with First service 5 for around 2.3 km, and
- Stagecoach services 10/10A/10B: overlap with First service 5 for around 2.3 km. Service 10B also overlaps with First services 1, 2, 3 and 30C.

106. Stagecoach submits that these services should be excluded from the OFT's assessment on the basis that (i) the overlaps account for a small portion of the relevant route revenues, (ii) some of the services are insufficiently frequent to compete with the overlapping service and/or (iii) the overlaps are too small to merit consideration.

107. In respect of Stagecoach's first argument, as outlined above (see paragraphs 61ff), OFT does not consider it appropriate to apply filters to exclude individual services on an overlap that is subject to competitive assessment. In respect of Stagecoach second argument, the OFT notes that the relevant overlaps are significant in distance terms (each is over two km) and therefore the OFT does not consider it appropriate to treat them as insignificant. However, it is not necessary to conclude on these points since the exclusion of these services (and their revenue) does not affect the OFT's decision.

Intra-Ilfracombe

108. First services 30 and 32 overlap with Stagecoach service 21A. The overlaps are short in distance (around one km) and account for a small amount of revenue. Taking these factors together, the OFT has not found it necessary to undertake a substantive assessment in respect of these overlaps and in any event the exclusion of these services (and their revenue) does not affect the OFT's decision.

Intra-Bideford

109. Stagecoach service 70/70A overlaps with First services 1 and 2 for around 300 metres in Bideford. Given the very short distance, the OFT has not found it necessary to undertake a substantive assessment in respect of these overlaps any in any event the exclusion of these services (and their revenue) does not affect the OFT's decision.

Conclusion on overlap flows

110. The OFT believes it is or may be the case that the merger will give rise to a substantial lessening of competition in respect of the following overlaps:

- Barnstaple-Ilfracombe,
- Barnstaple-Bideford/Westward Ho!/Appledore, and
- Barnstaple-South Molton.

Competition for tenders

111. Stagecoach and First are both active in bidding for tender contracts from Devon and Cornwall County Councils.

112. Stagecoach submits that the merger will not materially reduce competition for tenders. It points to the fact that there was an average of 3.6 bids per contract in Devon County Council's most recent tender round and that First has not been a strong competitor,

winning only one of the 19 contracts available in Devon County Council's most recent tender round.

113. Neither Devon County Council nor Cornwall County Council considered that the merger would significantly reduce competition for tenders. One local authority considered First was a relatively weak competitor and that the main competition was between Stagecoach and other local operators.

114. In light of the above evidence, the OFT does not believe that the transaction gives rise to concerns in respect of competition for tenders.

Network competition

115. The OFT has considered whether the merger would give rise to a loss of actual or potential competition between Stagecoach and First at a network level, such that the effects of the merger could be expected to extend beyond the overlap flows.

116. The evidence available to the OFT indicates that there is limited actual competition between Stagecoach and First at a network level. Multi-journey tickets account for a relatively small portion of the parties' revenue, suggesting that customer demand for multi-journey trips is limited. Furthermore, the parties' networks do not overlap significantly outside of the Barnstaple-Ilfracombe, Barnstaple-Bideford/Westward Ho!/Appledore and Barnstaple-South Molton corridors assessed above.

117. As regards loss of potential competition, the evidence available to the OFT indicates that the prospect of the parties entering against one another where they do not already overlap is relatively remote. In particular, most of the services outside these main corridors are fully or partially-tendered, suggesting that there is insufficient demand to support commercial services. Accordingly, the OFT considers that, even absent the merger, there is limited scope for entry and therefore the merger does not give rise to competition concerns through the loss of potential competition between the parties.

118. Accordingly, the OFT has not identified serious competition concerns at a network level. However, it is not necessary to reach a conclusion on network level competition since it does not affect the OFT's decision.

Barriers to entry and expansion

119. Where the combination of merging businesses raise potential concerns about the ability to raise prices or reduce quality or, in the case of transport mergers, reduce frequencies, the OFT also considers the responses of others. 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.⁴⁴

120. Stagecoach submits that it will be constrained by the threat of entry and/or expansion following the merger. Stagecoach points to its own entry in 2006 as evidence that successful entry is possible.

121. The CC report identifies a number of barriers to entry and expansion into the supply of local bus services, some of which appear to be especially relevant in North Devon.

122. First, the CC 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.⁴⁵ The OFT considers that this is likely to be a barrier to entry in North Devon. The OFT understands that Stagecoach incurred [] losses when it first entered the Barnstaple-Bideford corridor. Several third party operators stated that they would expect entry to be unprofitable, even in response to a post-merger price increase or deterioration in service and that this would act as a barrier to their entering new routes.

⁴⁴ OFT/CC Merger Assessment Guidelines, section 5.8.

⁴⁵ CC, Local bus services report, paragraph 9.16.

123. Second, the CC found that fear of an aggressive post-entry response from the incumbent can create a barrier to entry.⁴⁶ Third party comments in this case indicated that one reason why entry or expansion is unlikely is that potential entrants consider that Stagecoach's response would be likely to make entry unprofitable. Stagecoach submits that there are no grounds for entrant to fear strategic retaliation on its part, pointing to evidence that Stagecoach responded in only a small minority of cases in which it faced entry by a competitor.⁴⁷ However, even absent any strategic retaliation from Stagecoach, the fact that third parties considered post-entry responses would make entry unprofitable indicates that the prospects of such entry are low.

124. None of the third parties contacted by the OFT indicated that they would be likely to enter or expand against Stagecoach in response to a post-merger price increase or deterioration in service. Third parties could not cite examples of large-scale new entry in North Devon in last three years and did not expect any significant new entry in the foreseeable future.

125. The OFT understands that entry and expansion may be less difficult in respect of competition for tender contracts. However, such entry or expansion would not be effective to address the competition concerns identified by the OFT on the Barnstaple-Ilfracombe, Barnstaple-Bideford/Westward Ho!/Appledore and Barnstaple-South Molton corridors.

126. Accordingly, the OFT does not consider entry or expansion would be sufficiently timely and likely to mitigate its concerns.⁴⁸

⁴⁶ CC, Local bus services report, paragraph 9.38(a).

⁴⁷ CC, Local bus services report, paragraph 6.140.

⁴⁸ The OFT notes that this finding is not inconsistent with its finding that third parties may have been interested in acquiring the North Devon Business. In particular, the OFT considers that entry or expansion is likely to be significantly easier when it benefits from the goodwill of an existing business.

THIRD PARTY VIEWS

127. Specific third party views have been discussed above where relevant. While some local people were unconcerned, a larger number were concerned the merger would result in fare increases and/or frequency reductions. A travel user group also expressed concern that the merger would result in fare increases and/or frequency reductions.

ASSESSMENT

128. The parties currently overlap in the provision of local bus services in North Devon, supplying more than a quarter of such services in the local authority areas of North Devon and Torrington, which comprise a substantial part of the UK, such that the share of supply test is met.

129. Based on the evidence available, including from third parties, the OFT cannot exclude as unrealistic the prospect that the North Devon Business could have been sold to a substantially less anti-competitive purchaser absent the merger. The OFT therefore adopts prevailing competitive conditions as the counterfactual against which to assess the merger.

130. The OFT considers that the relevant frames of reference in this case are local bus services (both on overlap flows and a network level in North Devon) and competition for tender contracts (in the North Devon area).

131. The current transaction involves a reduction in competition on certain overlap flows. In terms of actual overlap flows, the merger results in a merger to monopoly in terms of effective competitors on the flows between Barnstaple and Ilfracombe, Barnstaple and Bideford/Westward Ho!/Appledore and Barnstaple and South Molton.

132. 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 to prevent competition concerns from arising, nor that actual entry or expansion is likely.

133. On this basis, 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 at least on the overlap flows between Barnstaple and Ilfracombe, Barnstaple and Bideford/Westward Ho!/Appledore and Barnstaple and South Molton.

134. The OFT has left open the question of whether the test for reference is met in relation to a number of smaller overlaps and network level competition as determination of these would not change the OFT's conclusion in this case.

EXCEPTIONS TO THE DUTY TO REFER

De minimis

135. The parties submit that, were the OFT to find itself under a duty to refer, it should exercise its discretion to apply the markets of insufficient importance (or 'de minimis' exception) under section 33(2)(a) of the Act.

136. Stagecoach submits that the size of the affected markets is £2.5 million, reflecting revenue on Stagecoach services 21A and 308 and First service 3 on the Ilfracombe-Barnstaple flows and revenue on Stagecoach service 21/21A and First service 1 and 2 on the Barnstaple-Bideford/Westward Ho!/Appledore flows.

137. The OFT considers that £2.5 million represents the minimum affected market size and that the affected markets are likely to be worth up to £3.2 million when the following revenue is included:⁴⁹

- First service 31 and First service 30C on the overlap flows between Barnstaple and Ilfracombe
- Stagecoach service 85, service 315 and service 319 on the

⁴⁹ As regards tendered services, the OFT considers that the revenue attributed to the affected market should include (i) fare revenue on the tendered service, and (ii) potentially also a proportion of the tender contract value, which the OFT based on the proportion of total route fare revenue earned on the overlap flow.

overlap flows between Barnstaple and Bideford

- Stagecoach service 6, 8/8A, 71/72, 12, 9, 10/10A/10B on the overlap flows within Barnstaple
- Stagecoach service 155 and service 307 and First service X7 and service 5/5C on the overlap flows between Barnstaple and South Molton, and
- a proportion of the parties' £[] off-bus revenue (from bus station sales, ticket machine sales etc.), which the parties have been unable to attribute to specific flows.

138. Accordingly, it is not clear that the value of the affected markets is less than the £3 million level at which the OFT will generally consider that a reference to the CC is not justified.⁵⁰ In any event, even if the affected market was worth £2.5 million, the OFT does not consider it appropriate to apply the de minimis exception in this case for the reasons below.

139. First, the OFT considers that the likelihood of consumer harm is high in respect of the Barnstaple-Ilfracombe and Barnstaple-Bideford/Westward Ho!/Appledore overlap flows where intense pre-merger competition will be replaced by a monopoly. In addition, there is documentary evidence indicating that Stagecoach may be able to increase fares and/or reduce frequency on the flows as a result of the merger.⁵¹

140. Second, the OFT considers that the magnitude of competition lost will be substantial on the Barnstaple-Ilfracombe and Barnstaple-

⁵⁰ OFT Exceptions to duty to refer and undertakings in lieu of reference guidance, paragraph 2.15.

⁵¹ For example, Stagecoach Submission, Annex 9. Stagecoach submits that this document reflects only a high level analysis and that its business model means it would have no incentive to increase prices. However, the OFT considers that Stagecoach's assumption that it would have the ability to increase prices and/or reduce frequencies indicates that it would possess significant market power following the merger.

Bideford/Westward Ho!/Appledore overlap flows where intense pre-merger competition will be replaced by a monopoly. As such, the merger could be expected to lead to substantial price increases and/or reductions in quality.⁵²

141. Third, the OFT considers that significant entry or expansion is unlikely and therefore the OFT believes that competitive harm arising from the merger could be expected to endure for several years.

142. Accordingly, the OFT considers that direct impact of the merger in terms of consumer harm is particularly significant and does not consider it appropriate to exercise its discretion to apply the de minimis exception in this case.

143. The OFT also notes that the nature of the local bus sector means that the transaction is highly replicable. In particular, there are likely to be a large number of relatively small local markets in bus sector where a merger could give rise to competitive harm. 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.⁵³ Accordingly, the OFT believes that consideration of the replicability of the transaction also points against exercise of the de minimis discretion in this case.

144. The OFT notes that the facts of the current case are materially different to Midland General Omnibus/Felix bus where the OFT applied the de minimis exception. In particular, the affected market in that case was worth less than £1 million and there was no evidence of strong pre-merger competition between the parties.

⁵² OFT Exceptions to duty to refer and undertakings in lieu of reference guidance, paragraph 2.36.

⁵³ CC, Local bus services report, paragraph 15.357.

Furthermore, the exceptional nature and size of the parties limited the extent to which the transaction was viewed as replicable.⁵⁴

Relevant customer benefits

145. Under section 33(2)(c) 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.

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

147. Stagecoach submits that the merger would give rise to customer benefits by enabling it to make sufficient returns to invest in fleet enhancement, high frequency services and good value fares. Stagecoach also submits that the merger would result in cheaper multi-journey tickets that provided access to a greater network of routes.

148. The OFT requires detailed and verifiable evidence that benefits will accrue to customers.⁵⁵ However, no such evidence has been produced in this case. In addition, some of the claimed benefits (high frequency and good value fares) are inconsistent with the expected market outcomes given the OFT's finding on the likely loss of competition arising from the merger.

⁵⁴ OFT decision, completed acquisition by Midland General Omnibus Limited of the commercial bus services of Felix Bus Services Limited, 30 May 2012.

⁵⁵ OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraph 4.9.

149. Furthermore, the parties have not submitted evidence to demonstrate that the benefits could not be obtained in the absence of the merger.⁵⁶

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

UNDERTAKINGS IN LIEU OF REFERENCE

151. Where the duty to make a reference under section 33(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which may result from it.

152. In considering such undertakings in lieu of reference, the OFT's published guidance makes clear the requirement that remedies must provide a clear-cut means of addressing the relevant competition concerns.⁵⁷

153. The parties made a number of offers of undertakings in lieu of a reference to the OFT to address the local unilateral effect concerns. The remedies, as offered by Stagecoach were to:

- [] the tenders for services []
- guarantee a minimum daytime frequency on service 21 between Braunton and Bideford of at least every ten minutes and between Braunton and Ilfracombe and Bideford and Westward Ho!/Appledore of every 20 minutes for a period of three years, and

⁵⁶ OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraph 4.7.

⁵⁷ OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraph 5.6.

- to guarantee the provision of commercial evening and Sunday services on service 21 for three years between Ilfracombe and Appledore/Westward Ho!.

154. The OFT's position, as set out in its guidance and discussed above, is that undertakings in lieu should act in a clear-cut fashion.

155. The second and third of the proposed remedies are of a behavioural nature. The OFT is generally unlikely to consider that behavioural undertakings will be sufficiently clear cut to address the identified competition concerns.⁵⁸ In this case, having examined the undertakings in lieu offer carefully, the OFT does not consider such remedies to be clear-cut and considers that the risks associated with behavioural undertakings as identified in the OFT's guidance would be present in this case.⁵⁹

156. Furthermore, the remedies only address one parameter of competition (frequency) and do not address the risk of degradation of other important competitive parameters including fares, bus quality and reliability. Even in respect of frequency, the proposed remedies do not ensure the maintenance of current frequency levels on all sections of the overlap flows.

157. The first of the proposed remedies is inadequate to address the concerns on the relevant overlap flows. First, it is not clear that the remedy is capable of ready implementation in a manner that would address the competition concerns. For example, it is not clear []. Furthermore, it is not clear whether []. Second, even if successfully implemented, the remedy would not remove the merger overlap on the relevant overlap flows:

⁵⁸ OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraph 5.39.

⁵⁹ OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraphs 5.40 and 5.41.

- in respect of overlap flows between Barnstaple and Bideford, even if service [] were operated by a third party, that would be insufficient to replicate the competition lost by combining all of the parties' services on the overlap flows (including their most frequent service 21/21A and services 1 and 2), and
- in respect of overlap flows between Barnstaple and South Molton, even if service [] were operated by a third party, that would be insufficient to replicate the competition lost by combining all of the parties' services on the overlap flows.

158. As such, given that the remedies offered do not address the competition concerns identified by the OFT in a sufficiently clear-cut fashion, the OFT does not consider it appropriate to suspend its duty to refer to consider undertakings in lieu of reference.

DECISION

159. The anticipated transaction will be referred to the Competition Commission pursuant to section 33(1) of the Act.