

Completed acquisition by Groupe Eurotunnel S.A. of certain assets of former Seafrance S.A.

**ME/5570/12**

The OFT's decision on reference given on 29 October 2012. Full text of decision published 12 November 2012.

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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. Groupe Eurotunnel S.A. (**Eurotunnel**) operates in a number of freight and logistics markets. It achieved revenues from inter alia the operation of the Channel Tunnel rail link and freight train services (Le Shuttle) through the Channel Tunnel.<sup>1</sup> The Channel Tunnel consists of three tunnels running under the English Channel, connecting the port terminals at Folkestone in England and Coquelles in France. Eurotunnel transports passengers and freight, and their vehicles, in specially designed shuttle carriages, which run through the Channel Tunnel from Folkestone to Coquelles. Eurotunnel also controls Europorte SAS (**Europorte**), which is a holding company controlling a range of rail freight subsidiaries and port infrastructure (including responsibility for maintenance at Dunkerque Sea Port). For the 2011 calendar year, Eurotunnel achieved a group turnover of €845 million (approximately £730 million).<sup>2</sup>
2. Seafrance S.A. (**SeaFrance**) was a 100 per cent owned subsidiary of Société Nationale des Chemins de fer Français (**SNCF**), which ran a fleet of four passenger and freight ferries between Dover and Calais. SeaFrance was placed in administration by the French Commercial Court of Paris (the

<sup>1</sup> The Channel Tunnel is operated by Eurotunnel under a concession agreement which was signed in 1986 initially for a period of 55 years, which has since been extended so it will operate for a total of 99 years.

<sup>2</sup> Based on an average exchange rate for 2011 of €1 = £0.8683

**Court**) on 30 June 2010. Following unsuccessful bids for the SeaFrance business during administration, the Court ordered its liquidation on 16 November 2011, at which point the ferry service between Dover and Calais ceased operating. For the 2011 calendar year, before it ceased operating, SeaFrance generated turnover of approximately £41.5 million in the UK.<sup>3</sup>

## **TRANSACTION**

3. On 11 June 2012, Eurotunnel was declared successful in its bid for certain assets of the former SeaFrance business (**Transaction**). The SeaFrance business had entered administration and offers were solicited for the business as a going concern. The Court did not accept any offers made at this stage. The Court then ordered that the SeaFrance business enter into liquidation and its assets were sold off. Eurotunnel was the successful bidder in this liquidation and the assets purchased by Eurotunnel included three ferry vessels,<sup>4</sup> SeaFrance logos, brand and the trade name, computer software, websites and domain names, IT systems, customer records<sup>5</sup> and the inventory of technical and spare parts as well as IT hardware and office equipment (**Transferred Assets**).
4. Eurotunnel recommenced operation of two of the vessels on the Dover/Calais route on 20 August 2012, under the name 'MyFerryLink'.<sup>6</sup>
5. The Office of Fair Trading (**OFT**) opened an investigation into the Transaction on 22 June 2012. The statutory deadline is 16 December 2012 and the administrative deadline is 29 October 2012.

<sup>3</sup> In 2011, SeaFrance achieved a turnover of approximately £83 million. Allocating half of that to the UK gives a figure of £41.5 million. See below for a discussion of the relevant turnover for jurisdictional purposes in this case.

<sup>4</sup> The *SeaFrance Nord-Pas-de-Calais*, the *SeaFrance Rodin* and the *SeaFrance Berlioz*.

<sup>5</sup> Eurotunnel informed the OFT that while the customer records appeared to be part of the Transferred Assets at the time it submitted its bid, in fact they were held by SeaFrance's UK subsidiary, SeaFrance UK Limited. However, as the successful bidder in the French liquidation process, Eurotunnel was given the option (which Eurotunnel took up) of purchasing these records. Eurotunnel informed the OFT that it subsequently sold the customer records to Dover Calais Ferry Limited (DCF), a subsidiary of the SeaFrance SCOP, which acts as an agent for MyFerryLink in the sale of passenger services.

<sup>6</sup> Any references to MyFerryLink in this decision are specifically to differentiate Eurotunnel's shuttle and ferry services.

## JURISDICTION

6. For the purposes of the OFT investigating a transaction under the provisions of the Enterprise Act 2002 (the **Act**), the transaction must amount to a relevant merger situation. For this, two or more enterprises must cease to be distinct and either the annual UK turnover associated with the enterprise being acquired must exceed £70 million ('the turnover test'), or the enterprises which cease to be distinct supply or acquire at least 25 per cent of goods or services of any description in the UK, or a substantial part of it ('the share of supply test').<sup>7</sup>
7. Each of these elements is discussed in turn below.

### **Enterprises ceasing to be distinct**

8. Eurotunnel submitted that enterprises have not ceased to be distinct since the Transferred Assets did not constitute an enterprise for the purposes of section 129 of the Act. The term 'enterprise' is defined in section 129 of the Act as 'the activities, or part of the activities, of a business'. A 'business' is defined as 'a professional practice and ... any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.
9. OFT guidance states that in determining whether a transfer of assets constitutes an enterprise it may have regard to the presence of any number of components, most commonly including the employees working in the business and the assets and records needed to carry on the business, together with the benefit of existing contracts and/or goodwill.<sup>8</sup>
10. Eurotunnel submitted that there was no goodwill associated with the assets it purchased at the time of the Transaction. Specifically, it submits the following:
  - i. the Transferred Assets had been inactive for around six months before the Transaction

<sup>7</sup> Section 23 of the Act.

<sup>8</sup> OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.10.

- ii. there was no goodwill associated with the SeaFrance brand or the relevant vessels at the time of the Transaction
- iii. the former SeaFrance employees had already been made redundant and did not transfer to Eurotunnel as a part of the Transaction, and
- iv. various other assets necessary for the running of the ferry business did not transfer to Eurotunnel (such as berthing rights/port slots at Calais and Dover, fuel contracts, other supply contracts, maintenance records, shipping charts and insurance).

11. Eurotunnel further submitted that there has been a loss of goodwill toward the SeaFrance business. Specifically, it submitted that:

- i. The SeaFrance brand is not currently being used by Eurotunnel because it has negative connotations for customers in terms of unreliability and service delivery. This was principally because SeaFrance had ceased operating shortly before going into liquidation and customers had therefore found it necessary to switch to another ferry operator or Eurotunnel itself.
- ii. Regular users of cross Channel transport services (freight customers in particular) are unlikely to hold any goodwill toward SeaFrance. Freight customers use ferry services several times a week and, therefore, in terms of frequency of use, are analogous to grocery store or cinema customers who have featured in previous OFT decisions on shut down businesses no longer constituting an enterprise.<sup>9</sup> Given that freight customers accounted for approximately 70 per cent of SeaFrance's turnover, Eurotunnel argued that the loss of goodwill amongst freight customers was especially damaging to the overall goodwill of SeaFrance.<sup>10</sup>
- iii. For infrequent users of cross Channel transport services there is either no, or very limited, goodwill transferred since, for example, passengers would not have been able to use SeaFrance over the

<sup>9</sup> For example, the OFT drew attention to frequency of use by customers when considering whether a closed grocery store was likely to contain material levels of goodwill in *The assignment of a lease to Tesco plc for the site of a former FreshXpress store at St Helens*, OFT decision on 21 April 2009.

<sup>10</sup> Eurotunnel also submitted that the fact that SeaFrance ceased operating in November 2011, immediately prior to the busy Christmas period, would have been very damaging to the goodwill of SeaFrance.

Christmas period of 2011 or the bulk of the busy summer period in 2012. This is supported, in Eurotunnel's view, by the fact that [ ].<sup>11</sup>

12. The OFT has carefully considered the above evidence presented by Eurotunnel. In its consideration of the evidence and following its established guidance, the OFT has taken into account the following factors: (i) the physical assets; (ii) goodwill; (iii) continuity of service; (iv) staff; and (v) customer records.

### **Physical assets**

13. OFT guidance states that the transfer of physical assets alone may be sufficient to constitute an enterprise where they enable a particular business activity to be continued.<sup>12</sup> In this case the OFT notes that Eurotunnel paid a total consideration of €65 million for the Transferred Assets of which the three former SeaFrance vessels accounted for almost 95 per cent of the purchase price. Two of the vessels purchased by Eurotunnel are especially suited to the short sea Channel crossing (**Short Sea**)<sup>13</sup> because they are fitted with double ramps and therefore enable vehicle loading on two levels. The OFT considers that the vessels acquired enable the activity of operating a ferry business, and that these specific vessels enable the operation of Short Sea ferry crossings, in particular.

### **Goodwill**

14. The OFT also considered whether there was any goodwill associated with the Transferred Assets. The OFT notes that the operation of vessels on the Short Sea, even under a different brand name, may give rise to the transfer of goodwill. The assets themselves and their usage on the Short Sea may give rise to a transfer of goodwill. In addition, the OFT considers that a number of intangible assets acquired by Eurotunnel had SeaFrance goodwill associated with them. The OFT notes that €2.8 million of the purchase price paid by Eurotunnel was attributed to the intangible assets, including trademarks, domain names, IT systems and customer records of the former SeaFrance business. Moreover, the OFT notes that P&O bid [ ] for the

<sup>11</sup> [ ].

<sup>12</sup> OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.10.

<sup>13</sup> The Short Sea route consists of routes across the narrowest sections of the English Channel and the Belgian Straits.

SeaFrance customer database and domain names which indicates that there may be some inherent commercial value in them.

15. As set out above, Eurotunnel has now recommenced operations under the MyFerryLink brand. The [www.SeaFrance.co.uk](http://www.SeaFrance.co.uk) web address is still active and automatically redirects customers to [www.MyFerryLink.com](http://www.MyFerryLink.com). This indicates that there is at least some goodwill associated with the SeaFrance brand. For example, ownership of the SeaFrance domain names means that MyFerryLink will achieve higher internet search results for customers using the search term 'SeaFrance'. The OFT considers that this places MyFerryLink at an advantage as compared with a new entrant in the ferry services market, and again, indicates that there is some goodwill associated with the SeaFrance brand.
16. In addition, consumer research commissioned by Eurotunnel in May 2012 to evaluate customers' awareness and usage of travel brands, found that [ ] per cent of Eurotunnel customers were aware of the SeaFrance brand and slightly over [ ] per cent of Eurotunnel customers had used SeaFrance.<sup>14</sup> These results are consistent with the SeaFrance brand maintaining some level of goodwill.<sup>15</sup>

### **Continuity of service**

17. The OFT states in its guidance that the fact that a business is no longer actively trading does not in itself prevent it from being an enterprise for the purposes of the Act.<sup>16</sup> Where this is the case, in addition to the factors generally applicable to assessing the existence of an enterprise, the OFT will also consider:
  - the period of time elapsed since the business was last trading
  - the extent and cost of the actions that would be required in order to reactivate the business as a trading entity
  - the extent to which customers would regard the acquiring business as, in substance, continuing from the acquired business, and

<sup>14</sup> Eurotunnel: *Understanding Customer Research*, Delivered by OMD Insight, May 2012. Results were based on a survey of 5,018 people.

<sup>15</sup> The survey also found that SeaFrance did not appear on the list of brands which customers would consider using instead of Eurotunnel which may reflect the fact that SeaFrance, or any of its vessels, was not operating at that time. The OFT did not receive the survey questions or information on how the results were presented and so can place little weight on them.

<sup>16</sup> OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.11.

- whether, despite the fact that the business is not trading, goodwill or other benefits beyond the physical assets and/or site themselves could be said to attach to the business and part of the sale.
18. The period of time elapsed since SeaFrance was last trading before the completion of the Transaction was six months. The OFT generally considers that the regularity of custom is relevant for assessing whether the period of closure has meant that goodwill has wholly or in a large part been dissipated.<sup>17</sup> Previous cases considering this issue have dealt with grocery retailers,<sup>18</sup> cinemas<sup>19</sup> and entertainment retailers,<sup>20</sup> all of which tend to be visited by customers on a frequent basis (weekly or, possibly, monthly). Some ferry customers, in particular tourist passengers, may only use the service infrequently. The OFT considers that the goodwill has not dissipated as a result of the cessation of trading.<sup>21</sup> The OFT would also note that, even for those customers travelling on a more frequent basis, there could remain a certain degree of goodwill dependent on the routes travelled on, familiarity with crew and/or vessels and so on.
19. In addition, the evidence presented to the OFT indicates that, with the former SeaFrance vessels and the staff (via the SeaFrance SCOP) in place, Eurotunnel was able to offer a ferry service without significant cost expenditure. There was no need to undertake an extensive and costly exercise to operate the Transferred Assets as a ferry service. Eurotunnel told the OFT that it needed to secure berthing rights, fuel contracts and to get the requisite insurance in place. Eurotunnel said that its marketing was primarily online and therefore not especially costly. The OFT considers these to be normal commercial matters of an ongoing nature, not one-off activities to get a business up and running. It therefore follows that the key components of an enterprise were in place at the time of the Transaction.

<sup>17</sup> For example, the OFT discusses the frequency of grocery shopping in 'The assignment of a lease to Tesco plc for the site of a former FreshXpress store at St Helens', OFT decision on 21 April 2009.

<sup>18</sup> The assignment of a lease to Tesco plc for the site of a former FreshXpress store at St Helens, OFT decision on 21 April 2009.

<sup>19</sup> ME/3390/07 Anticipated acquisition by Cineworld Group plc, through its subsidiary Cine-UK Limited, of the cinema business operating at the Hollywood Green Leisure Park, Wood Green, OFT decision on 17 March 2008.

<sup>20</sup> ME/4036/09 Anticipated acquisition by HMV of 15 Zavvi stores, OFT decision on 28 April 2009.

<sup>21</sup> This is reinforced by the fact that the SeaFrance website is being redirected and the SeaFrance domain names are being used.

20. Given this evidence, on a cautious basis and applying the range of factors identified in the OFT's guidance (paragraph 18 above), the OFT has not found that the interruption to the ferry service is sufficient for it to conclude that Eurotunnel has not acquired an enterprise.

## Staff

21. Eurotunnel submitted that the Transferred Assets did not include employees. The OFT accepts that when a business enters into liquidation, the staff are made redundant. This severs the legal link between the staff and the Transferred Assets. In its guidance, the OFT would normally place reliance on certain contractual transfers of staff. In the UK, this might be as a result of the TUPE regulations.<sup>22</sup> This was not the case here.
22. However, the OFT does consider that the staff have, in effect, transferred to Eurotunnel. In the course of the SeaFrance administration, some of the former SeaFrance employees established a workers' co-operative known as the **SeaFrance SCOP**.<sup>23</sup> The initial purpose of the SeaFrance SCOP was to acquire the SeaFrance business.<sup>24</sup> The SeaFrance SCOP's bids for SeaFrance during administration failed because the Court considered that the bid price was too low.
23. As set out above, the administration process was closed and the SeaFrance business went into liquidation and bids were requested for the SeaFrance assets. It is important to note in this context that the SeaFrance SCOP formed an important part of Eurotunnel's bid for the Transferred Assets. Eurotunnel and the SeaFrance SCOP agreed to enter into long-term bareboat charter arrangements<sup>25</sup> if the Eurotunnel bid for the SeaFrance assets were to be successful. The Court assessed the Eurotunnel bid, taking into account these arrangements and made specific reference to the

<sup>22</sup> TUPE is The Transfer of Undertakings (Protection of Employment) Regulations 2006. OFT guidance says that the application of TUPE would be regarded as a strong factor in favour of finding that the business transferred constitutes an enterprise (OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.10).

<sup>23</sup> SCOP is the French acronym for Société Cooperative et Participative.

<sup>24</sup> Approximately 350 of the 865 former SeaFrance employees are members of the SeaFrance SCOP.

<sup>25</sup> 'Bareboat charter' means the hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew.

importance of these arrangements (alongside other factors, such as price and operating the vessels under the French flag) in its report on the liquidation. Under the bareboat charter arrangements, [ ].

24. As set out in its guidance, the OFT will have regard to the substance of an arrangement under consideration, rather than merely its legal form.<sup>26</sup> Although the employees of SeaFrance were not legally transferred to Eurotunnel as part of the Transaction, through the bareboat charter arrangements with the SeaFrance SCOP, Eurotunnel has, in effect, attained the services of the former employees of SeaFrance. The OFT therefore considers that the effect of these arrangements is similar to that of a legal transfer of employees in a business acquisition.
25. The OFT notes that this is consistent with the finding by the Monopolies and Mergers Commission (MMC) in *AAH Holdings plc/Medicopharma NV*.<sup>27</sup> In that case, Medicopharma UK employees were made redundant on the day it ceased trading. However, AAH requested that they report to their place of work once it recommenced trading, with a view to taking them on at least temporarily. In that case the MMC stated that: 'Thus although the employees of Medicopharma UK were issued with redundancy letters, the arrangements in effect provided AAH with the opportunity to take on all the employees at the three depots it acquired, and overwhelmingly (apart from senior staff) they were in fact taken on by AAH'. Although this case was investigated under the Fair Trading Act 1973, the legal test for determining whether enterprises have ceased to be distinct has not changed since then.
26. In any event, the OFT does not consider it is necessary to rely on the transfer of employees in order to find that an 'enterprise' has been transferred where a range of assets have been acquired for the reasons provided in this decision.

### **Customer records**

27. The OFT considers the transfer of customer records to be indicative of the transfer of an enterprise.<sup>28</sup> In this case, the customer records comprised

<sup>26</sup> OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.9.

<sup>27</sup> Monopolies and Mergers Commission: *AAH Holdings plc/Medicopharma NV*, Cm 1950 (May 1992), paragraph 6.88.

<sup>28</sup> OFT527 Mergers - Jurisdictional and procedural guidance, June 2009, paragraph 3.10.

two lists, one for passengers and the other for freight customers, including customer names, addresses and/or email addresses. Eurotunnel submitted that the customer lists are of limited commercial value because they are over six months old and customers will have already switched to alternative suppliers. However, the OFT noted that Eurotunnel accounted for the customer records in the purchase price which indicates that they have substantive value attached to them.

### **Conclusion on enterprises ceasing to be distinct**

28. For the reasons set out above, the OFT considers that the Transferred Assets, taken in the round, is or may be sufficient to constitute an enterprise for the purposes of section 23 of the Act.<sup>29</sup> In doing so, the OFT notes that the legal standard set out in the Act is that it is or may be the case that a relevant merger situation has been created. Moreover, the OFT notes, as it did in *Cineworld/Wood Green Cinema*, that in the event of doubts as to whether the Transaction does in fact constitute a relevant merger situation then it is appropriate that these doubts should be determined by the Competition Commission (CC) should the OFT reach the view that the merger raises a realistic prospect of a substantial lessening of competition.<sup>30</sup>

### **The turnover test**

29. Eurotunnel submitted that there is no turnover attributable to the Transferred Assets given that they have not been used to generate any turnover since November 2011. The OFT does not agree with this and considers that it is appropriate to use the turnover attributable to SeaFrance in 2011 or the last full financial year of operation.
30. Eurotunnel further submitted that if SeaFrance's 2011 turnover was used, the Transferred Assets generated turnover of approximately £83 million in

<sup>29</sup> The OFT notes that this is similar to the MMC's finding in *AAH Holdings plc/Medicopharma NV* where Medicopharma had ceased trading. Its entire stock, certain assets (including a computer system) and leases on two of its three largest depots (complete with fixtures and fittings) were sold to AAH. Although no customer contracts or staff were formally transferred, the MMC still found that an enterprise had been acquired.

<sup>30</sup> Anticipated acquisition by Cineworld Group plc, through its subsidiary Cine-UK Limited, of the cinema business operating at the Hollywood Green Leisure Park, Wood Green, OFT decision on 17 March 2008.

2011. Eurotunnel informed the OFT that competition authorities have previously adopted an approach of apportioning revenue on cross Channel ferry routes as being split equally between the country of origin and destination.<sup>31</sup> Given the limited information on the precise origin and destination of customers and in light of previous practice, the OFT considers that SeaFrance's UK turnover in 2011 does not satisfy the turnover test.<sup>32</sup> Moreover, Eurotunnel told the OFT that SeaFrance's UK customer-related activities generated less than half of its revenues in 2011.

31. The OFT therefore considers that the turnover test under section 23(1)(b) of the Act is not met.

### **The share of supply test**

32. Eurotunnel submitted that its share of supply in passenger and freight transport services across the Short Sea exceeded 25 per cent during the 2011 calendar year.<sup>33</sup> The former SeaFrance business (the operation of which has now been recommenced under the MyFerryLink brand) is also active in the supply of passenger and freight transport services across the Short Sea.
33. The data provided by Eurotunnel to the OFT indicate that SeaFrance had a share of supply in 2011 of approximately eight per cent for passengers and

<sup>31</sup> Decision of the French competition authority (Autorité de la concurrence): Décision du 9 décembre 2011 relative à la prise de contrôle exclusif d'actifs de la société SeaFrance et de la société LD Lines par la société DFDS.

<sup>32</sup> The OFT notes that there are a number of methods for geographical allocation of turnover in transport-related cases where the origin and destination are in different countries, including splitting the turnover equally between the country of origin and country of destination, allocating to the country of destination, or allocating to the country where the ticket sale occurred. However, the OFT notes that the turnover test is not met on any reasonable definition in this case.

<sup>33</sup> Eurotunnel informed the OFT that it had a share of supply for passengers of approximately [40-50] per cent in 2011 and approximately [45-55] per cent for the first six months of 2012, and a share of supply for freight of approximately [35-45] per cent in 2011 and approximately [40-50] per cent for the first six months of 2012.

13 per cent for freight.<sup>34</sup> The share of supply test in section 23 of the Act is therefore satisfied.

## COUNTERFACTUAL

34. As set out in its Merger Assessment Guidelines, the OFT considers the effect of a merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In practice, in completed mergers, this will generally be the pre-merger situation, unless the OFT considers that the prospect of those conditions continuing was not realistic. This may be, for example, because the OFT believes that one of the merger firms would inevitably have exited from the market.<sup>35</sup> Eurotunnel submitted that the counterfactual should be that, absent the merger, SeaFrance would have exited the market because the Transferred Assets were in liquidation.

### Exiting firm scenario

35. In forming its view of the exiting firm scenario, the OFT will consider:

- whether the firm would have exited (through failure or otherwise) and, if so
- whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration, and
- what would have happened to the sales of the firm in the event of its exit.<sup>36</sup>

<sup>34</sup> Eurotunnel submitted that MyFerryLink's activities for the period 20 August 2012 to 19 September 2012 equated to a share of supply of less than [0-five] per cent. Even, therefore, if one did use MyFerryLink's share of supply as an appropriate basis for the application of the share of supply test (and the OFT does not consider this to be the appropriate reference point in this case), the test would be satisfied.

<sup>35</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.5.

<sup>36</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.8 to 4.3.10.

## **Exit of SeaFrance**

36. The first step in assessing the appropriate counterfactual is for the OFT to consider whether SeaFrance would have exited the market absent the merger.<sup>37</sup>
37. As set out above, the Court placed SeaFrance into administration in June 2010 and ordered liquidation on 16 November 2011. The SeaFrance business continued operating throughout the period of administration. During administration there were attempts to sell SeaFrance as a going concern. This process involved bids by DFDS A/S (**DFDS**) and the SeaFrance SCOP which were rejected by the Court (further details of these bids are set out below).
38. Given that there were no successful bids for SeaFrance as a going concern, the Court ordered its liquidation on 16 November 2011. The vessels were then returned to port and sailings ceased. In January 2012 the Court formally liquidated SeaFrance and invited bids to acquire its remaining assets. The OFT is therefore of the view that, absent the merger, SeaFrance would have exited the market.

## **Would there have been an alternate purchaser for SeaFrance?**

39. The OFT has examined whether there were any other buyers of the Transferred Assets which would have represented a better outcome for competition than the acquisition made by Eurotunnel.<sup>38</sup> Taking into account the OFT's realistic prospect threshold, and the evidence available to it in the context of a first phase investigation, the OFT has assessed the Transaction against two counterfactuals that it considered to be the most realistic to occur in absence of the Transaction:
- i. the prospect that, absent the Eurotunnel purchase, new disposal terms would be offered by the Court and a less anti-competitive purchaser would feasibly have made a bid for the SeaFrance assets, and

<sup>37</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraphs 4.3.13–4.3.15.

<sup>38</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraphs 4.3.16–4.3.17.

- ii. the prospect that, absent the Eurotunnel purchase, one of the remaining bidders, most likely the next highest bidder (DFDS), would be declared by the Court as successful in acquiring the SeaFrance assets.<sup>39</sup>

40. The OFT notes that, on the evidence submitted to it, bids by DFDS for *SeaFrance Berlioz* and by Stena RoRo for *SeaFrance Rodin* would have together yielded a higher price than the single bid by DFDS for both vessels (paragraph 47). The OFT was informed that, if Stena had acquired *SeaFrance Rodin*, it would likely have moved it away from the Short Sea in order for it to be operated on a different route altogether. The OFT understands that Stena RoRo is the vessel chartering division of the Stena Line group of companies and therefore it is credible that in the event of Stena RoRo acquiring the vessel, the vessel would have exited the market. This is clearly not a better outcome for competition. As such, in this regard, on a cautious basis the OFT has assessed the credibility of DFDS acquiring two vessels since, (i) it is not clear that absent the Eurotunnel bid the sale of the vessels would have been split between DFDS and Stena RoRo, and (ii) a successful DFDS may have yielded a better outcome for competition which would represent a realistic alternate counterfactual.
41. Before assessing whether each of the alternative counterfactuals set out above would have represented a better outcome for competition, it is important to set out the reasons why the OFT considers that they may be the most appropriate alternative counterfactuals for an assessment of this limb of the exiting firm scenario.
42. Eurotunnel submitted that there was no alternative feasible purchaser for SeaFrance because, according to the reasoning set out in the Court order notification,<sup>40</sup> the Court would not have sold the Transferred Assets to another bidder. Eurotunnel argued that any other potential purchaser had

<sup>39</sup> The OFT notes that this is a similar approach to the one it took in *Lloyds/HBOS* where it assessed the merger against two counterfactuals that it considered to be the most realistic to occur in absence of the merger (*Anticipated acquisition by Lloyds TSB plc of HBOS plc*, OFT Report to the Secretary of State, 31 October 2008). In that case, the OFT found that there was a realistic prospect of a substantial lessening of competition as against one or both counterfactuals

<sup>40</sup> References to the Court order notification are to a 'convenience translation' of the original court order from French into English. The Court order notification is the document in which the Court declared Eurotunnel to be the transferee of the Transferred Assets.

an opportunity to bid for the Transferred Assets, but did not, and therefore there is no realistic counterfactual of the Transferred Assets having been bought by an alternative purchaser.

43. When considering the prospects for an alternative buyer for the firm or its assets, the OFT will generally take into account the prospects of alternative offers for the business above liquidation value.<sup>41</sup>
44. While SeaFrance was in administration, the Court considered two bids for SeaFrance as a going concern. One of these bids was from the SeaFrance SCOP for €1, and the other was from DFDS for €5 million. Both bids were rejected by the Court, because it considered that they were too low.<sup>42</sup> In particular, the Court noted that the €5 million bid from DFDS was substantially below the market value of the ships, which was considered to be between €50 and €60 million (though no account was taken of the company's liabilities).
45. The bids made in administration were considered by the Court to be below 'market value'. However, the OFT has limited evidence available to it to ascertain whether these bids were below 'liquidation value' (that is, the estimated amount of money that could be received quickly through the sale of assets of a company that is discontinued). The OFT understands from the available evidence that SeaFrance had significant liabilities. The evidence supporting this includes the Court order notification which indicates that SeaFrance had €100 million liabilities with respect to SNCF, €30 million in liabilities to banks and about €18 million in third party liabilities; third party responses which indicated that SeaFrance had liabilities, including significant employment liabilities; and the OFT understands that the French government requested approval from the European Commission in February 2011 to inject €223 million in state aid into SeaFrance in order to recapitalise it. This request was rejected by the European Commission. Consequently, the OFT is reasonably confident that the SeaFrance business had significant liabilities which may have approached or exceeded the value of any assets. It may, therefore, be the

<sup>41</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 4.3.5.

<sup>42</sup> The OFT has ascertained that the Court considered a revised bid by the SeaFrance SCOP on 6 January 2012 (a few days prior to formal liquidation of SeaFrance), but rejected it again, primarily because the bid price was still €1.

case that the liquidation value of the SeaFrance business was significantly below the value of the assets.

46. On 9 January 2012, the Court formally liquidated SeaFrance. Having appointed a broker to assist it with the sale of the ships, the Court decided that the sale through a private transaction would be the best way to maximize the sale price of the assets. The sale of the Transferred Assets was publicised through various channels, including websites and journals. As far as the OFT is aware, no guide price was published.
47. The OFT was informed that the following sealed bids were submitted to the Court in May 2012:
- P&O bid [ ] for the customer records and [ ] for the domain names
  - DFDS<sup>43</sup> bid €30 million for *SeaFrance Berlioz* and, separately, €25 million for *SeaFrance Rodin* (or, if it were to purchase both vessels, €50 million for the two)<sup>44</sup>
  - Stena RoRo AB bid €30 million for *SeaFrance Rodin*, and
  - Eurotunnel bid €65 million for all Transferred Assets.
48. In assessing whether each of the counterfactuals set out above were likely in the absence of the Eurotunnel purchase, the OFT is conscious that, in most cases, it will take the prevailing conditions of competition as the most appropriate counterfactual. In the context of the less anti-competitive purchaser test, this means that the realistic prospect threshold would ordinarily seek to show that all reasonable efforts to find an alternative purchaser have been undertaken. The OFT has considered each of the alternative counterfactuals below.

#### **Purchase by a new bidder**

49. With regard to the first counterfactual set out above, the OFT notes that it has the following limited information on the sales process undertaken by the Court:

<sup>43</sup> This bid was submitted by DFDS and Louis Dreyfus Armateurs through their joint venture in which DFDS holds a 82 per cent stake and Louis Dreyfus Armateurs holds an 18 per cent stake. For the purposes of this decision, this joint venture is referred to by the OFT as DFDS.

<sup>44</sup> DFDS submitted a revised bid on 25 May 2012, but this bid was declared inadmissible by the Court because it was submitted after 4 May 2012 which was the deadline set by the Court.

- i. A broker was appointed to assist with the sale.
- ii. Advertisement of the sale of the Transferred Assets was undertaken.
- iii. A reasonable period for bids to be submitted was set out.

50. This may indicate that, if there were any other purchasers, they would have made bids during the administration and/or the liquidation process. However, the OFT also notes that, absent the Eurotunnel bid, there was a possibility that the Court could reopen the process and issue new disposal terms. This much is clear on the face of the Court document inviting bids for the Transferred Assets ('Reference terms for bid remittance'). This states that 'the Receiver Judge is not bound to accept any of the collected bids and have the discretion to decide about new disposal terms'. Therefore, this raises the possibility that, absent the Eurotunnel bid, the Court process could have introduced new disposal terms which could have led to a new alternative purchaser for the Transferred Assets.

51. The OFT accepts that the majority of competitors who were likely to be interested in the vessels had made a bid in some form or other in the administration or liquidation (DFDS, Stena, P&O). However, there are other competitors active on the English Channel that did not make a bid (Brittany Ferries, Transeuropa Ferries and Condor Ferries). There may have been wider interest in the Transferred Assets as a result of any new disposal terms offered by the Court. Taking the evidence in the round, and in light of the need to take a cautious approach at the first phase and the fact that the OFT is not generally determinative in relation to the 'most realistic counterfactual' applicable to a particular fact pattern, the OFT considers that there was a realistic prospect that, absent the Eurotunnel purchase, new disposal terms would have been offered by the Court and a less anti-competitive purchaser would feasibly have made a bid for the SeaFrance assets.

### **Purchase by DFDS**

52. With regard to the second counterfactual set out above, the OFT notes that DFDS submitted a formal bid for the majority of the Transferred Assets and was the single next highest bidder in the process.<sup>45</sup> Even if, absent the

<sup>45</sup> The OFT notes that the Court would also have had the option of selling SeaFrance Rodin to Stena RoRo for €30 million, SeaFrance Berlioz to DFDS for €30 million, with the remaining Transferred Assets being disposed of separately. Although more transactions would have been involved, which could have raised the costs, this sale structure may have yielded a higher

Eurotunnel bid, DFDS had not been declared the successful transferee, Court may have re-offered the Transferred Assets on some other basis and DFDS may have submitted a revised bid. In this context the OFT notes that DFDS submitted a revised bid which was deemed inadmissible by the Court because it was submitted after the deadline. As such, the OFT considers that it is relevant to consider a purchase by DFDS as an alternative counterfactual in these circumstances.

53. With regard to whether a purchase by DFDS would have represented a better outcome for competition, Eurotunnel submitted that this would not have been the case because a purchase by DFDS would have left just two ferry operators on the Dover/Calais route, whereas the purchase by Eurotunnel introduced a third ferry competitor. Furthermore, Eurotunnel submitted that a purchase by DFDS might have led to coordinated effects concerns between it and P&O as the only two ferry operators on Dover/Calais route.
54. DFDS was only present on the Dover/Dunkirk route (and not on the Dover/Calais route) at the time when SeaFrance ceased sailing. However, in partnership with Louis Dreyfus Armateurs,<sup>46</sup> it entered that route in February 2012. Table 1 below compares the combined shares of supply (and increments) of DFDS and SeaFrance (had DFDS's bid been successful) to those of Eurotunnel and SeaFrance on the Short Sea during 2011.

combined price than the Eurotunnel bid. However, if Stena RoRo had acquired the *SeaFrance Rodin*, it may have operated it elsewhere than the Short Sea. Therefore, the OFT does not consider that this would necessarily have led to a better outcome for competition than the Transaction.

<sup>46</sup> This was part of the agreement to enter into a joint venture with Louis Dreyfus Armateurs in which DFDS holds an 82 per cent stake and Louis Dreyfus Armateurs an 18 per cent stake. For the purposes of this decision, this joint venture will be referred to as 'DFDS'.

**Table 1: Combined shares of supply on the Short Sea (2011, per cent)**

	Eurotunnel	DFDS
Passengers	[50-60] (+ [5-15])	[20-30] (+ [5-15]) <sup>47</sup>
Freight	[50-60] (+ [10-20])	[20-30] (+ [10-20]) <sup>48</sup>

55. Table 1 indicates that Eurotunnel and SeaFrance’s combined share of supply on the Short Sea was approximately double the combined share of supply of DFDS and SeaFrance, for both passengers and freight.
56. The OFT also notes that, at the time when SeaFrance went into liquidation, DFDS was only present on the Dover/Dunkirk route, and therefore Eurotunnel and SeaFrance would likely have been closer competitors than DFDS and SeaFrance. This is further supported by the diversion evidence set out below.
57. Furthermore, if DFDS had been successful in purchasing the vessels, it is likely that it would have formed a strong third player in the market for transport services across the Short Sea. Eurotunnel’s purchase, on the other hand, has resulted in two strong players and a weaker third player.
58. For the reasons set out above, the OFT considers that it may be the case that a purchase by DFDS would have produced a better outcome for competition than the Eurotunnel purchase.

#### **Conclusion on less anti-competitive purchaser**

59. On either of the alternative purchaser scenarios set out above, the OFT considers that, absent the acquisition by Eurotunnel, there was a realistic prospect of a less anti-competitive purchaser for the Transferred Assets which would have led to a better outcome for competition. In conclusion, therefore, the OFT cannot conclude with the requisite degree of confidence that there would not have been an alternative purchaser for the Transferred Assets. Consequently, this limb of the failing firm scenario is not met in this case. The OFT has therefore examined the Transaction on the basis of a more competitive counterfactual.

<sup>47</sup> The increment may have been less for DFDS given that one vessel is unlikely to have been purchased.

<sup>48</sup> See footnote above.

## What would have happened to the sales of SeaFrance?

60. Finally, the OFT's Merger Assessment Guidelines state that the OFT will consider what would have happened to the sales of an exiting firm absent the merger. Given the OFT's conclusion above regarding the existence of a purchaser which may have resulted in a better outcome for competition, the OFT did not consider it necessary to conclude on what would have happened to SeaFrance's sales in the absence of the Transaction.

## FRAME OF REFERENCE

61. The parties overlap in the provision of transport services for passengers and freight customers across the Short Sea.
62. Both the OFT and the Commission have previously distinguished between passenger and freight transport services.<sup>49</sup> Ferry operators often carry both freight and passengers on the same vessels, although some vessels are purpose-specific. The vessels included in the Transferred Assets and Eurotunnel all carry both freight and passengers.

### Product scope - Passengers

Passengers – Segmentation by mode of transport

63. In *P&O/Stena Line*,<sup>50</sup> the European Commission concluded that passenger transport by Eurotunnel and by ferry operators are substitutable and are therefore part of the same product market. In *DFDS/LD Lines*,<sup>51</sup> the OFT assessed the merger on the basis of both ferry operators and Eurotunnel, although the precise product scope was left open.
64. Eurotunnel agreed that, in line with *P&O/Stena Line*, the product scope for passenger services should include ferry operators and Eurotunnel. It also argued that it and ferry operators on the Short Sea are constrained by

<sup>49</sup> ME/5500/12 Anticipated acquisition by DFDS of certain routes between the UK and continental Europe operated by Louis Dreyfus Armateurs SAS, OFT decision dated 7 August 2012 and M.5756 DFDS/Norfolk, 17 June 2010.

<sup>50</sup> M.2838 P&O/Stena Line 7 August 2002.

<sup>51</sup> ME/5500/12 Anticipated acquisition by DFDS of certain routes between the UK and continental Europe operated by Louis Dreyfus Armateurs SAS, OFT decision dated 7 August 2012.

competition from airlines which have developed low cost offerings in recent years. The majority of third parties submitted that air transport should not be included in the frame of reference, primarily because airline travel combined with car hire was not a feasible alternative that they would switch to.

65. On the basis of the available evidence, the OFT has examined the Transaction on the basis of passenger services including ferry operators and Eurotunnel only.

#### Passengers – Segmentation by tourist and business

66. Whilst some ferry operators accept passengers travelling on foot, the majority of passengers travel with their vehicle. Eurotunnel only accepts passengers travelling with their vehicle, with foot passengers travelling by Eurostar, which is a separate (and non-affiliated) legal entity. Previous cases have found that, compared with business passengers, tourist passengers are likely to be more price rather than time sensitive. In *P&O/Stena Line*,<sup>52</sup> for example, the European Commission defined separate markets for business and tourist passenger services.
67. However, the OFT has not received any data segmented by business and tourist passengers. Consequently, it has been unable to determine the impact on its analysis of segmentation between business and tourist passengers. The OFT has therefore left the frame of reference open in this regard and examined the Transaction on the basis of all passenger transport services (including both ferry services and Eurotunnel). The OFT has attempted to distinguish between any competitive effects that would separately affect business or tourist passengers where possible.

#### Product scope – Freight

##### Freight – Segmentation by mode of transport

68. The OFT considered whether freight transport services across the Short Sea should be segmented by mode of transport.

<sup>52</sup> M.2838 P&O/Stena Line 7 August 2002.

69. In *DFDS/LD Lines*,<sup>53</sup> the OFT assessed the merger on the basis of all freight (accompanied and unaccompanied) transported by ferry operators and Eurotunnel on the basis that Eurotunnel competes with the cross Channel ferries for customers in terms of the frequency and price of its service, although the precise product scope was left open.
70. With regard to crossing duration, Eurotunnel informed the OFT that there is a significant difference in the crossing duration between Eurotunnel and ferries operating across the Short Sea. The crossing time by Eurotunnel is around 40 minutes, whereas the ferry crossing takes over one and a half hours. The OFT received responses from several freight customers of the parties, the majority of which responded that they would switch to alternative ferry services for their non-express freight, but not for their express freight.
71. All freight customers that responded to the OFT's enquiries informed the OFT that they generally purchase cross Channel freight transport via annual (or longer term) contracts, with set prices subject to changes in bunker fuel charges. They usually have contracts with a number of different operators. The operators are not aware of what percentage of the freight will be express, and therefore are unable to price differentiate between express and non-express freight. Furthermore, freight customers informed the OFT that they do not book shipments with a particular operator, rather they arrive in port and take the next available crossing. This further limits the operators' ability to identify or price differentiate between express and non-express freight at the time when they set their prices.
72. Finally, Eurotunnel informed the OFT that it is not able to carry some large or hazardous loads, which must be transported by ferry. However, one third party estimated that such goods only account for approximately one per cent of all goods transported on the Short Sea. Given that customers cannot be identified at the point at which prices are set, firms are unable to price discriminate between customers for hazardous and oversized goods.
73. On the basis of the available evidence, the OFT has examined the Transaction on the basis of ferry services and Eurotunnel together.

<sup>53</sup> ME/5500/12 Anticipated acquisition by DFDS of certain routes between the UK and continental Europe operated by Louis Dreyfus Armateurs SAS, OFT decision dated 7 August 2012.

## Freight - Segmentation by type of vessel

74. Eurotunnel submitted that freight can be transported by different types of vessels between Continental Europe and the UK; roll-on/roll-off (**Ro-Ro**) accompanied traffic, Ro-Ro unaccompanied traffic, and lift on/lift off (**Lo-Lo**) traffic. Eurotunnel submitted that the different types of vessels have different characteristics, which affect their substitutability for a particular route. Eurotunnel submitted that loading and unloading of Ro-Ro vessels is quicker than Lo-Lo vessels, and unaccompanied vessels are generally preferred on routes with longer crossing times, primarily because there is no need to pay a driver to remain with the load.
75. In *DFDS/Norfolk*<sup>54</sup> the European Commission identified a variety of factors, including that some goods cannot be containerised and that transport on Ro-Ro is faster than on Lo-Lo, suggesting that Ro-Ro and Lo-Lo vessels could be considered to be separate markets. It also found that Ro-Ro vessels require less in the way of port infrastructure than Lo-Lo vessels, which need to be unloaded with cranes. The European Commission analysed the transaction and accepted commitments based on a Ro-Ro market. The Competition Commission has previously found that services for the same type of freight (accompanied versus unaccompanied) were likely to be closer substitutes than services for different types.<sup>55</sup>
76. However, in this case the OFT notes that all traffic on the Short Sea is accompanied Ro-Ro traffic (including the former SeaFrance business as recommended by MyFerryLink) and there is no such distinction in the transport services offered by Eurotunnel. The OFT has therefore not distinguished between the types of vessel for the purposes of its assessment in this case.

## Geographic scope

77. In previous cases involving transport across the English Channel, both the OFT and the European Commission have identified the following broad geographic markets:

<sup>54</sup> M.5756 DFDS/Norfolk 17 June 2010.

<sup>55</sup> Competition Commission 'A report on the completed acquisition by Stena AB from DFDS A/S of certain vessels and assets operated in the Irish Sea', 29 June 2011, paragraph 5.22.

- the Short Sea
- the North Sea (consisting of routes between ports on the east coast of England and ports in Belgium and the Netherlands), and
- the Western Channel (consisting of routes between ports on the south coast of England and ports on the north coast of France).

78. Eurotunnel submitted that the geographic frame of reference should be wider than the Short Sea due to the constraint imposed by other routes. However, due to its higher frequency of crossings and shorter crossing time, the OFT has previously assessed a merger on the basis of the Short Sea for both passengers and freight.<sup>56</sup>
79. Around half of the large freight customers that responded to the OFT's enquiry indicated that, in response to a small but significant non-transitory increase in price (**SSNIP**), they would either definitely not switch between routes, or would be unlikely to do so. With regard to passengers, the responses received by the OFT were mixed. Some indicated that only those firms present on the specific Dover/Calais route were Eurotunnel's competitors, while others indicated that other routes also compete. A minority of passengers that responded to the OFT's enquiries indicated that budget airlines also compete with Eurotunnel and ferry operators.
80. Competitors indicated that their prices differ depending on the route and the season, with passenger prices commonly determined using a yield management system. One competitor submitted that although there may be some constraint on price in the North Sea from the Short Sea, the constraint is asymmetric, with no constraint from the North Sea to the Short Sea.
81. Both the former SeaFrance business and Eurotunnel only operated on the Short Sea. For the reasons set out above, the OFT assessed the Transaction on the cautious basis of the Short Sea, although noted as part of the competitive assessment that ferry services operating on the same route may be closer competitors to each other than services operating on different routes.

<sup>56</sup> ME/5500/12 Anticipated acquisition by DFDS of certain routes between the UK and continental Europe operated by Louis Dreyfus Armateurs SAS, OFT decision dated 7 August 2012.

## Conclusion on frame of reference

82. For the reasons set out above, the OFT assessed the Transaction on the basis of:

- freight transport services (including ferry services and Eurotunnel) across the Short Sea, and
- passenger transport services (including ferry services and Eurotunnel) across the Short Sea.

## HORIZONTAL ISSUES

### Shares of supply

83. Eurotunnel provided the OFT with share of supply estimates based on 2011 data from IRN Freight Ferrystat. Based on these data, Eurotunnel and SeaFrance had a combined share of supply of passenger transport services on the Short Sea of approximately [50-60] per cent, with an [five-15] per cent increment, and a combined share of supply of freight transport services of approximately [50-60] per cent, with a [10-20] per cent increment (see Table 2 below).<sup>57</sup>

**Table 2: Shares of supply on the Short Sea (2011, per cent)**

	Passenger	Freight
Eurotunnel	[40-50]	[35-45]
SeaFrance	[5-15]	[10-20]
<b>Combined</b>	<b>[50-60]</b>	<b>[50-60]</b>
P&O	[25-35]	[30-35]
DFDS	[10-20]	[10-20]

Source: IRN Freight Ferrystat

84. The data provided to the OFT by third parties corroborate these shares of supply.

<sup>57</sup> The OFT notes that one vessel previously operated by SeaFrance (*MV SeaFrance Molière*) was owned by a consortium of creditors, and as such did not form part of the Transferred Assets. The *MV SeaFrance Molière* accounted for approximately 24.5 per cent of SeaFrance's total revenues in 2011. In order to take into account the fact that Eurotunnel did not purchase this vessel in the shares of supply, the OFT has recalculated the shares by distributing *MV SeaFrance Molière's* sales to the remaining operators in proportion to their shares of supply.

85. Eurotunnel submitted that, for the purposes of the unilateral effects analysis, the share of supply that should accrue to SeaFrance/MyFerryLink is that which MyFerryLink has generated since it started operating on 20 August 2012. This equates to a share of supply of less than [0-five] per cent on the Short Sea route for both freight or passenger transport.<sup>58</sup> However, given the short time that MyFerryLink has been operating and that Eurotunnel has not yet even utilised one of the vessels (due to be put into service later this year), the OFT does not consider the current share of MyFerryLink to be a realistic representation of what Eurotunnel has gained as a result of the Transaction. The OFT notes that customers were unable to book on MyFerryLink prior to 20 August 2012, so its market share may be expected to increase as customers have the opportunity to book ahead. Therefore, the OFT considered that it was more appropriate, on a cautious basis, to use SeaFrance's 2011 shares of supply, removing the estimated share attributable to the vessel that was not transferred as part of the Transaction.
86. Eurotunnel also submitted that the Transaction should be viewed as pro-competitive because it has increased the number of ferry operators on the Short Sea from two to three. However, as set out above, the OFT has concluded that the Eurotunnel forms part of the same economic market as ferry services, and therefore does not consider that the Transaction has increased the number of operators on the Short Sea.
87. Furthermore, several third parties told the OFT that Eurotunnel already holds a leading position in transport across the Short Sea and that the Transaction would lead to a strengthening of that position.
88. The shares of supply above and the concentrated nature of the Short Sea crossings market raise prima facie concerns over unilateral effects and therefore the OFT has considered whether a substantial lessening of competition may arise as a result of the Transaction by reference, first, to the closeness of competition between Eurotunnel and SeaFrance before the Transaction.

<sup>58</sup> Eurotunnel submitted that MyFerryLink achieved total transport revenues of approximately £[ ] for the period 20 August 2012 to 19 September 2012.

## Closeness of competition

89. Eurotunnel submitted that Eurotunnel and P&O are the closest competitors to each other in the market, due to their frequency of service and price points. The OFT considered certain events in the market for transport on the Short Sea which can be used to ascertain the closeness of competition between operators.

### Exit of SeaFrance – implied diversion to other operators on Short Sea

90. The exit of SeaFrance itself is one such event. The OFT was provided with market share data covering January to June 2012, the period after which SeaFrance ceased operating. The OFT has used these data to estimate the extent to which previous customers of SeaFrance have switched to alternative operators and thus a proxy for diversion ratios from SeaFrance to other operators, including Eurotunnel (see Table 3 below).<sup>59</sup>

**Table 3: Implied diversion ratios from SeaFrance (per cent)**

	Diversion	
	Passenger	Freight
Eurotunnel	49	36
P&O	48	42
DFDS (Dover/Dunkirk)	4	23

Note: Figures sum to over one hundred due to rounding.

91. The implied diversion ratios presented in Table 3 are consistent with responses provided by freight customers to the OFT. The OFT notes that the low diversion for DFDS customers is likely to be due to the fact that DFDS entered the Dover/Calais route in February 2012 and therefore customers may have switched to the Dover/Calais route from the Dover/Dunkirk route. Of the freight customers who provided data to the OFT in response to its enquiry, the majority of their volume is transported

<sup>59</sup> In order to estimate this proxy for diversion ratios, the OFT has taken the share of supply that each operator achieved between January and June 2012, and used it to produce an estimate of the volume that would have been carried in 2012 by each operator if SeaFrance had remained inactive. The OFT has assumed that the market would have remained the same size in 2012 as it was in 2011. The market share for January to June 2012 was then multiplied by the estimated market size for 2012. The difference between the projected 2012 volume and actual 2011 volume was then divided by SeaFrance's 2011 volume. The OFT notes two principle limitations to this approach: (i) it does not take account of seasonality; (ii) DFDS entered the Dover/Calais route in February 2012.

using P&O and Eurotunnel for the Dover/Calais route. They informed the OFT that this is because P&O and Eurotunnel provide the most frequent service on that route.

92. The implied diversion ratios in Table 3 indicate that Eurotunnel was a close competitor to SeaFrance along with P&O for both passengers and freight. Eurotunnel submitted that transport volumes are highly seasonal and therefore submitted alternative diversion ratios to the OFT, which it claims are seasonally adjusted. These diversion ratios indicate that P&O is the closest competitor to SeaFrance for both passengers and freight, and that Eurotunnel is the second closest competitor.

#### Impact of entry of DFDS on Dover/Calais route

93. Eurotunnel also submitted data surrounding the entry of DFDS onto the Dover/Calais route in early 2012. The data compare the volumes achieved by P&O and Eurotunnel between the exit of SeaFrance and the entry of DFDS (December 2011 to February 2011) and during the two months that followed the entry of DFDS (April 2012 to June 2012). The data indicate that, for freight, P&O and DFDS (on the Dover/Dunkirk route) suffered more from the entry than Eurotunnel did, and therefore that Eurotunnel is a more distant competitor. The OFT considers it inappropriate to place significant weight on this evidence given that, as acknowledged by Eurotunnel, it is difficult to disentangle the effects of the entry of DFDS/LD Lines from those of the exit of SeaFrance due to the closeness in timing of these events. Furthermore, the OFT notes that, for passengers, the data show both Eurotunnel and P&O gaining customers despite the entry of DFDS.
94. Eurotunnel also submitted that it has gained new customers as a result of the recession (for example, customers who previously travelled by air), which increased its passenger volumes during the period analysed rather than the increase in passengers being those that switched from SeaFrance. However, it has not provided any evidence to support this.

#### Impact of Channel Tunnel closure in 2008

95. Furthermore, Eurotunnel also submitted data following the Channel Tunnel fire in 2008. The data indicate that, of the ferry operators, P&O picked up the most passenger volume from Eurotunnel, and SeaFrance the second

most. For passengers, the data indicate that P&O captured 13 per cent of the volume lost by Eurotunnel while SeaFrance captured four per cent. With regard to freight, the data indicate that initially SeaFrance picked up the most volume from Eurotunnel, and P&O the second most. Eurotunnel argued that P&O is Eurotunnel's closest competitor for freight, but that the data showing initial switching fails to show this due to the restricted capacity of P&O at peak times. According to Eurotunnel, the data show that the customer switching to SeaFrance was temporary and only for the period when P&O was capacity constrained. When capacity became available at P&O, the switching to SeaFrance did not persist and SeaFrance lost much of the business it had won to P&O.

96. The OFT notes that Eurotunnel's arguments, that the initial switching to SeaFrance was over-stated due to P&O's lack of capacity, is not probative of the absence of unilateral effects. P&O was and is able to provide a competitive constraint only when it has spare capacity, which during peak periods Eurotunnel itself submitted it does not. During peak periods, when customers cannot switch to P&O because it is capacity constrained – even if P&O would have been their preferred second choice – they would have had no other option but to switch to DFDS or, in particular (as it operated on a similar route), SeaFrance.

#### Analysis of prices offered on the Short Sea

97. Eurotunnel further submitted that other ferry operators are closer competitors of SeaFrance than Eurotunnel in terms of the prices offered to customers. Not only are Eurotunnel's prices significantly higher than those of the ferry operators (due to a lower travel time and higher frequency of service), but its prices do not correlate with those of the ferry operators. The data submitted by Eurotunnel indicate that, while the prices of Eurotunnel and ferry operators correlate across daytime and night time periods, the variation between different times of day are more significant for the ferry operators. The OFT is of the view that this lack of correlation is likely to be partly due to the limited capacity of Eurotunnel. It is also not clear to the OFT how the pricing data was collated. Consequently, the OFT does not consider the pricing evidence provided by Eurotunnel to be sufficient to show that Eurotunnel and SeaFrance are not close competitors.

## Conclusion on closeness of competition

98. Overall, the data indicate that Eurotunnel and P&O are the closest competitors to each other for both passenger and freight customers, with SeaFrance being the second closest to each. From SeaFrance's perspective, the available data indicate that P&O was its closest competitor for freight customers, with Eurotunnel its second closest competitor. For passenger customers, Eurotunnel and P&O offered equally good alternatives. This is consistent with responses received from third parties.
99. The OFT notes that Eurotunnel's argument that P&O is a closer competitor to Eurotunnel (and SeaFrance) than Eurotunnel and SeaFrance are to each other is not in itself probative of a lack of potential unilateral effects. Given that the market is concentrated and characterised by a limited number of operators, the issue for the OFT is whether Eurotunnel and SeaFrance are sufficiently close competitors, not whether there is one equally close or closer competitor to Eurotunnel than SeaFrance or SeaFrance than Eurotunnel. The evidence presented to the OFT suggests that, although P&O is a strong competitor to both merging parties, SeaFrance exerted a competitive constraint on Eurotunnel and Eurotunnel exerted a strong competitive constraint on SeaFrance. The OFT considers that the removal of those constraints may be sufficient to give rise to unilateral effects concerns in the supply of ferry services on the Short Sea.
100. The OFT considers that there are two realistic counterfactuals absent the merger: a no overlap purchaser or DFDS. The OFT has therefore considered whether there is a realistic prospect of a substantial lessening of competition arising as a result of the Transaction set against each of these two realistic counterfactuals.

## Competitive assessment against DFDS counterfactual

101. To assess whether a realistic prospect of a substantial lessening of competition would arise as against the counterfactual that an in-market player would have acquired the Transferred Assets requires an assessment of the competitive position of the identified alternative purchaser as against its competitors in the relevant market. In this case, the OFT considers that, based on the evidence available to it, had DFDS been successful in acquiring the vessels, this would have led to the presence of three strong players in the market for passenger and ferry transport across the Short

Sea: Eurotunnel, P&O and DFDS, that is, the transfer of the Transferred Assets would realistically have served to strengthen the position of DFDS as against the pre-merger position. Therefore, the OFT considers that the current Transaction, while amounting to a similar reduction in the number of players (when merely counting operators, that is, from four to three) has led to a different competitive dynamic than that which the OFT, based on the evidence, reasonably predicts that a DFDS acquisition would result in. In particular, as the evidence set out above on the dynamics of competition post-merger reveals, the third player, DFDS is in a relatively weak position compared to the stronger players P&O and Eurotunnel. The OFT considers that given SeaFrance's exit it would be better for the SeaFrance assets to be transferred to a much weaker rival than to transfer to one of its strongest rivals.

102. The OFT has considered whether events following the exit of SeaFrance have made DFDS a more rivalrous and competitive force than it was before. The evidence does not point to DFDS' entry providing a strong counterweight to P&O and Eurotunnel and this rivalry will be further reduced in view of the Transaction. Specifically, it is not clear that the operations of DFDS on the Short Sea crossings are sufficient to enable it to be a viable efficient competitor. Eurotunnel itself submitted that this was the case stating that DFDS' current operations would be insufficient to run a commercially viable ferry service across the Short Sea. The OFT notes that Eurotunnel put forward at a very late stage in the proceedings a very recent announcement by DFDS relating to the chartering of a further vessel, the *Molière*, to operate on the Short Sea (on the Dover/Dunkirk route) carrying passengers and freight.

103. The OFT understands from a DFDS press statement that another DFDS vessel, *Deal Seaways*, currently used on the Short Sea on the Dover/Calais route, will be withdrawn and returned to her owners, and the DFDS vessel, *Dover Seaways*, will be re-deployed on that route from its current route, Dover/Dunkirk.<sup>60</sup> Therefore, the use of the *Molière* will not increase the number of vessels on either the Dover/Dunkirk route or the Dover/Calais route. The aggregate increase in capacity available for freight passengers on the Dover/Calais route is 15 trailers. In the context of overall journeys on the Short Sea market, this does not increase the ability of DFDS to compete on an efficient basis by a great deal than its current operations.

<sup>60</sup> 'DFDS Seaways strengthens Channel Service', 24 October 2012.

Absent evidence from DFDS that it intends to increase and build its capacity on the Short Sea, the OFT cannot confidently state that DFDS is as strong a competitor as Eurotunnel in this market and it is also not clear to the OFT that DFDS will be able to remain on this route given the lower frequency of its service.

#### Competitive assessment against a new bidder

104. The alternative counterfactual as described in paragraphs 49 to 51 above is to assess the competitive position against the realistic alternative that a non-overlap operator had been successful in acquiring the vessels. The OFT considers, based on the evidence available to it, that this would have led to the presence of four players on the market for passenger and ferry transport across the Short Sea: Eurotunnel, P&O, DFDS and the non-overlap operator. Although DFDS and the non-overlap operator may have been relatively weaker players than Eurotunnel and DFDS, Eurotunnel's position would not have been strengthened by the purchase of SeaFrance. The OFT is of the view that the constraint imposed by three other operators is significantly greater than two, and therefore the possible rise in prices is less likely under the counterfactual.

105. The OFT therefore considers that there is a realistic prospect that the Transaction will lead to a significant lessening of competition on either counterfactual. Nevertheless, the OFT has considered whether sufficient spare capacity lies within the industry which could be utilised in order to prevent price rises post-Transaction.

#### Competitive impact of capacity on the Short Sea

106. The OFT considers that capacity may be an important dimension to competition in this market. It is not clear to the OFT that the Transaction leads to more capacity becoming available in the market relative to either of the counterfactuals set out above. In particular, the OFT notes that if the Transaction leads to exit by DFDS from the Dover/Calais route, as against the counterfactual of the assets having been acquired by DFDS (due to it not having sufficient frequency to be an efficient competitor), then the Transaction may lead to a reduction in capacity on this route. Even if capacity remains unchanged on the route, the Transaction will result in a larger share of this capacity being concentrated within the Eurotunnel group.

107. The OFT has considered the relevant load factor and available capacity of the various operators – particularly as regards freight. Eurotunnel submitted that it operates at [ ] capacity. At the time of the Transaction it was achieving an average load factor of approximately [ ] per cent for freight traffic through the Tunnel, [ ]. Eurotunnel submitted that [ ]. For passengers, Eurotunnel submitted that there is some scope to increase volume but that demand patterns differ (for example, there is spare capacity at night when passengers are less willing to travel). Eurotunnel submitted that different wagons are used for freight and passenger vehicle transport, and therefore it would not be possible to divert spare capacity onto passenger shuttles for freight use.

108. The OFT's guidelines state that a price rise by the merged firm may be made more profitable if competing suppliers may not have the capacity to meet demand from some customers who would like to switch in response to the price rise.<sup>61</sup> According to Eurotunnel, ferry operators on the Short Sea have considerable spare capacity – with the exception of P&O during peak periods – that would allow them to easily accommodate large volumes of switching of demand by customers away from Eurotunnel (if it attempted to increase its prices or reduce the quality or frequency of its service).<sup>62</sup> Third parties agreed that there is overcapacity within the ferry segment of the market. While the OFT recognises that there is some spare capacity within the ferry segment of the market, it is unlikely that this would be sufficient to defeat a price rise by Eurotunnel, given the likely level of spare capacity relative to Eurotunnel's sales volumes.

109. Furthermore, although the OFT does not view cross Channel transport services as being homogenous (where the existence of excess capacity in the hands of competitors can dampen a firm's ability to raise prices),<sup>63</sup> capacity constraints at peak times are an important consideration in this case. A number of customers, especially freight passengers, may need to

<sup>61</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.4.11.

<sup>62</sup> The OFT notes that P&O currently run six vessels on the Dover/Calais route (with up to 26 sailings per day), DFDS currently runs three vessels on the Dover/Dunkirk route and two vessels on the Dover/Calais route (with up to 22 sailings per day), and MyFerryLink, as of the first quarter of 2013, will run three vessels on the Dover/Calais route (with at least 16 sailings per day).

<sup>63</sup> See, for example, *Anticipated acquisition by RMIG Limited of Ash & Lacy Perforators Limited*, ME/4166/09, 26 August 2009.

travel on a time sensitive basis on point to point journeys across the Short Sea in order to ensure they meet certain agreed delivery timescales. Although Eurotunnel does not price discriminate between those freight customers that travel at peak times, a price rise for all customers may be profitable as long as there are sufficient customers that prefer to travel at peak times and there is insufficient capacity on other ferry operators to accommodate them. Eurotunnel submitted that P&O would be unable to accommodate such passengers at peak times. Given that DFDS currently runs a less frequent service than P&O, it is not clear to the OFT that DFDS would have sufficient capacity at peak times in order to offset a price rise by Eurotunnel.

110. As set out above, the OFT considers P&O to be Eurotunnel's closest competitor, and SeaFrance to be its second closest. Consequently, even if DFDS were to have substantial capacity, it is not clear to the OFT that this would be sufficient to offset the loss of competition and choice for some customers that the Transaction may give rise to. The fact that Eurotunnel is also capacity constrained at peak times increases the likelihood that it would attempt such a price rise.

111. The OFT therefore considers on a cautious basis that the levels of capacity on the Short Sea (especially in light of capacity constraints at peak times) may not be sufficient to prevent Eurotunnel from raising prices.

### **Barriers to switching**

112. The OFT notes in its Merger Assessment Guidelines that unilateral effects are more likely where customers have little choice of alternative supplier because of the level of switching costs.<sup>64</sup> In this case, the business, or part of the business, that made up SeaFrance has been removed as an independent supplier of cross Channel transport services and, in addition, there may be some costs to switching between the remaining suppliers, at least for some customers. Although Eurotunnel submitted that customers for transport across the Short Sea can switch easily between operators, some third parties submitted that the volume related discounts for freight customers represent a barrier to switching, as it gives hauliers an incentive to concentrate their volume with a limited number of operators. As such,

<sup>64</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.4.5.

the presence of switching costs may increase the likelihood of unilateral effects arising as a result of the Transaction.

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

113. The OFT considered whether entry into the transport market across the Short Sea is timely, likely and sufficient.<sup>65</sup> The OFT has assessed the likelihood of entry by a non-specified operator given that Eurotunnel considers that barriers to entry are low. It has also assessed the timeliness, likelihood and sufficiency of entry and/or expansion by new and/or existing operators on the Short Sea crossings, namely Euroferries and DFDS in relation to each of passenger and freight transportation.

#### Timeliness

114. With regard to the timely nature of any potential entry, third parties informed the OFT that a new entrant would not only need to obtain a suitable vessel to operate on the Short Sea, it would also need to obtain berthing slots at the port. Other barriers which may prevent entry being timely include whether there were suitable vessels available on the market, the amount of modification required to the vessels to fit the port infrastructure, various certification requirements and availability of trained crew.

#### Likelihood

115. With regard to the likelihood of any potential entry, the OFT considers that the purchase of a new vessel involves significant capital cost. However, the OFT also notes that vessels can also be chartered through bare boat charter agreements.<sup>66</sup> One third party estimated that the cost of operating and sailing a typical vessel between Dover and Calais is between £25 and £30 million per annum. With the exception of Euroferries (which is addressed further below), the OFT has not identified any other potential entrants on the Short Sea as a result of its enquiries.

116. One third party informed the OFT that obtaining berthing port slots on the Short Sea is difficult, because the port of Dover is congested. This is

<sup>65</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.8.3.

<sup>66</sup> For example, the OFT notes that the *MV SeaFrance Molière* is currently available for charter.

consistent with a submission from DFDS that it was unable to obtain port slots at Dover until SeaFrance had ceased sailings. This indicates that barriers to entry on the key Dover/Calais route may be higher.

117. Competitors also informed the OFT that the current levels of capacity on the Dover/Calais route would make entry unattractive. One competitor also indicated that Eurotunnel's strong position on the Short Sea would also be likely to deter any prospect of new entry. Only one competitor told the OFT that it is relatively easy to enter the Short Sea, citing the example of DFDS entering the Dover/Calais route.

#### Sufficiency

118. With regard to the sufficiency of any potential entry, Eurotunnel submitted that, in order to run a commercially viable ferry service across the Short Sea, a ferry operator would require three vessels (in order to achieve sufficient frequency of sailings). The OFT also notes two examples of firms which entered the market and subsequently exited in the last five years (Speedferries in 2008 and Louis Dreyfus Lines in 2010). Although this indicates that entry is achievable, it also indicates that successful and long-lasting entry is difficult.

#### Euroferries – analysis of new entry on passenger ferries segment

119. Eurotunnel submitted that a new entrant, Euroferries, is planning to launch a new ferry service on the Short Sea (from Ramsgate to Boulogne) in February 2013. Eurotunnel submits that this illustrates the feasibility and timeliness of new entry. The OFT has been provided with evidence from third parties in relation to Euroferries, which suggests that it has in the past announced the launch of (and marketed) new ferry services to, in the main, passengers which have not materialised.<sup>67</sup> [ ]. The OFT therefore considers that, if Euroferries were to launch a ferry service for passengers on the Short Sea in 2013, this would not be evidence of timely entry.

120. Further, Euroferries told the OFT that it will be concentrating on passenger customers, not freight customers. Therefore, the OFT does not consider the entry of Euroferries to be sufficient to offset the OFT's unilateral

<sup>67</sup> In February 2012 the Advertising Standards Agency investigated whether Euroferries were misleading customers into thinking that its ferry service on the Ramsgate to Boulogne route was already up and running.

effects concerns arising from the Transaction. In addition, the fact that Euroferries has not yet started operating, and will be operating on the Ramsgate/Boulogne route not the Dover/Calais route (where entry barriers may be higher), means that there is no evidence of the competitive constraint that Euroferries will impart. This adds to the uncertainty that it will defeat any substantial lessening of competition arising from the Transaction.

#### DFDS – analysis of expansion potential

121. With regard to expansion, the OFT notes the press announcement made by DFDS concerning its ferry service operation on the Short Sea (as set out in paragraphs 102 to 103 above).

122. Whilst the new ferry being chartered by DFDS (Molière) will be used on the Dover/Dunkirk route, it merely replaces an existing vessel, the *Dover Seaways*, which will now be redeployed onto the Dover/Calais route. The *Dover Seaways* will, in turn, replace the *Deal Seaways* on the Dover/Calais route, which will be redelivered to its owner to be operated on another route outside the relevant geographic scope. Therefore, the OFT does not consider that the announced developments will lead to any material change in capacity on the Short Sea,<sup>68</sup> or offset any substantial lessening of competition that may arise as a result of the Transaction. Neither do they indicate, on the basis of the evidence available, that DFDS is about to profitably increase or expand its capacity on the Short Sea imminently.

123. The OFT currently considers on a cautious basis that entry and/or expansion is unlikely to be sufficiently timely, likely and sufficient to prevent a substantial lessening of competition from arising.

#### Conclusion on unilateral effects

124. In conclusion, taking into account the combined shares of supply, the evidence on closeness of competition and the relatively high barriers to entry the OFT considers that there is a realistic prospect that the Transaction may be expected to result in a substantial lessening of competition in the form of increased prices on either the Eurotunnel or

<sup>68</sup> DFDS has informed the OFT that the developments will lead to a reduction in passenger capacity of 600 passengers per sailing on the Dover/Dunkirk route, and an increase in 15 trailers on the Dover/Calais route.

MyFerryLink services. The OFT considers this to be the case relative to a counterfactual of either DFDS successfully acquiring the SeaFrance vessels or a non-overlap operator acquiring them.

125. On the evidence currently available to it, the OFT is not persuaded, to the relevant standard required, that either the levels of capacity in the market or the recent announcements by Euroferries and DFDS will prevent a substantial lessening of competition from arising.

## **NON-HORIZONTAL ISSUES**

126. In assessing the Transaction, the OFT also considered some non-horizontal theories of harm:

- partial input foreclosure resulting from the inter-availability agreements
- facilitating predatory behaviour, and
- bundling.

127. The OFT has set these theories of harm out in more detail below, but did not consider it necessary to conclude on whether there is a realistic prospect that they will lead to a substantial lessening of competition given the OFT's conclusion on unilateral effects above.

### **Partial input foreclosure**

128. There are inter-availability agreements in place between Short Sea ferry operators and Eurotunnel. These agreements provide that one operator will carry passengers<sup>69</sup> for the other in the event that they are unable to carry passengers due to circumstances out of their control. The inter-availability agreements therefore act as a form of insurance for operators. No similar agreements are in place for freight transport given that freight customers generally have arrangements in place with several operators.

129. The inter-availability agreements are currently reciprocal, both between ferry operators themselves and between ferry operators and Eurotunnel. The rates applied under the inter-availability agreements are agreed on an annual basis for the forthcoming year. The OFT considered whether,

<sup>69</sup> Inter-availability agreements are not entered into in relation to freight customers.

following the Transaction, Eurotunnel has an incentive to either increase the price at which it offers the inter-availability agreements to competitors, which would have the effect of increasing their marginal costs, or to give priority to customers of MyFerryLink, thereby worsening the service provided to other operators.

130. Some third parties indicated that Eurotunnel's status as the most weather immune Short Sea crossing option means that ferry operators rely heavily on their inter-availability agreements with it, and that Eurotunnel may prioritise MyFerryLink in some way.
131. Eurotunnel submitted that all of its capacity could not be carried by MyFerryLink as it currently only has two vessels in service. However, the OFT is of the view that Eurotunnel would at least be partially insured. The OFT notes that any discrimination between the terms offered to ferry operators by Eurotunnel may become apparent to customers and tour operators and, as such may impact their view of the quality of service that the ferry operators are able to provide. This may lead them to favour MyFerryLink above another ferry operator.
132. Alternatively, Eurotunnel may increase the rates for other ferry operators, thereby increasing their marginal costs. Given Eurotunnel's position at the most weather immune transport service on the Short Sea, it may have the ability to engage in input foreclosure. In terms of incentive, Eurotunnel will find it profitable to increase input prices, if as a result rivals' customers divert to Eurotunnel or if ferry operators do not have the ability to impose a similar price increase on Eurotunnel.
133. In terms of effect on competition, an increase in rival ferry operators' costs above those of MyFerryLink may reduce the number of sailings that competitors are able to run, possibly inducing exit from the market as set out above. Such exit will reduce the constraint imposed on MyFerryLink and Eurotunnel, enabling them to increase prices. However, Eurotunnel provided data on the number of occasions such inter-availability agreements have been used in recent years and the revenue generated by such agreements, which indicates that both are minimal.<sup>70</sup>

<sup>70</sup> For example, in 2011, such revenue amounted to the equivalent of [ ] per cent of the group's total revenue.

134. The OFT did not consider it necessary to conclude on whether there is a realistic prospect that such a strategy will lead to a substantial lessening of competition given the OFT's conclusion on unilateral effects above.

### **Facilitating predatory behaviour**

135. The OFT received several third party concerns relating to whether the Transaction would lead to predatory behaviour by Eurotunnel. The OFT therefore considered the extent to which the Transaction may enable Eurotunnel to provide an aggressive response to entry or to induce exit by using profits earned on one product or service to subsidise short run losses on another product or service. As set out above, although the tunnel and ferry services are not sufficiently different to result in separate markets, they are differentiated in the type of service that they provide.

136. If MyFerryLink were to charge prices below average cost (while subsidising these services using profits from the Eurotunnel service), this may prompt rival ferry operators to decrease the frequency of their service or exit the market. If Eurotunnel were able to induce the exit of DFDS from the Dover/Calais route, for example, there would only be two remaining operators on this route (P&O and Eurotunnel), although there would remain three operators on the Short Sea. This may enable the remaining operators to worsen their offering, absent (re-)entry.

137. The OFT considered whether Eurotunnel would have the ability to engage in such a strategy, which would only be the case if it earned sufficient profits in its core activity to cross subsidise a loss-making ferry business and the other ferry operators would not be able to cross subsidise their Short Sea operations from their other routes.

138. The OFT is of the view that Eurotunnel's incentive to cross-subsidise will be dependent on the ability of rivals to sustain losses over a period of time, the diversion from Eurotunnel to ferry operators if ferry prices fall and Eurotunnel does not decrease its price, the extent of any effect on Eurotunnel's price of a price decrease in the ferry segment of the market, whether Eurotunnel will be able to induce exit of a rival from the ferry segment of the market, and the ability of Eurotunnel to increase prices after exit (which will be affected by the ease of re-entry and the constraint from the Dover/Dunkirk route which is in the same geographic market). The

effect of such a strategy may lead to worsening in the competitive offering if it successfully induces the exit of a ferry operator.

139. The OFT did not consider it necessary to conclude on whether there is a realistic prospect that this strategy will lead to a substantial lessening of competition given the OFT's conclusion on unilateral effects above. It is mindful that its guidance says that: 'in certain situations, foreclosure may involve behaviour that is unlawful under competition law. In assessing how this might impact on the incentive to carry out the behaviour in question, the OFT may take into account whether the behaviour would be clearly, or highly probably, unlawful; whether the behaviour would be likely to be detected; and the potential consequences of such behaviour (for example, enforcement action taken by the OFT)'.<sup>71</sup> Given the OFT has not found it necessary to conclude on this theory of harm in this case, it has not found it necessary to apply this framework of analysis.

## **Bundling**

140. As set out in the Merger Assessment Guidelines, mergers may raise concerns that the merged firm might increase the selling price of one of its products when sold on a stand-alone basis, but might not do so if customers buy both the merged firm's products;<sup>72</sup> this would give customers an incentive to buy the second product from the merged firm as well, putting rivals in the second product market at a disadvantage. Several third parties raised concerns that the Transaction would result in a bundling strategy by Eurotunnel.

141. In order for a substantial lessening of competition to arise based on a bundling theory of harm, Eurotunnel would need to have significant market power in tunnel services, both transport services must have a common pool of customers and the transport services must be complements. Furthermore, the bundled transport services must be offered for sale at a price that rival ferry operators could not match. The OFT does not believe that a bundling theory of harm would arise for individual passengers, but

<sup>71</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.6.14.

<sup>72</sup> OFT1254 Merger Assessment Guidelines, Joint publication of the Competition Commission and the OFT, September 2010, paragraph 5.6.13.

that it might arise for tour operators and freight operators, who may have a demand for a bundle of shuttle and ferry services.

142. Tour operators (or similar businesses) are likely to want to offer customers the option of ferry or Eurotunnel crossings. As Eurotunnel is the only provider of tunnel services on the Short Sea, it is likely to have an assured listing in some operators' catalogues. Eurotunnel may be able to leverage their assured listing by offering a rebate, contingent on exclusively listing their services. Consequently, if rival ferry operators are unable to match the bundled price offered by Eurotunnel, this will lead to foreclosure. The OFT was provided with data that indicates that some of the discounts offered by Eurotunnel are greater than the ferry operators' median price, and as such there is no possibility of them matching the discount.
143. With regard to freight, some customers told the OFT that they prefer to use Eurotunnel for express services, and the cheaper ferry services for empty loads travelling back from the UK to mainland Europe. Therefore, Eurotunnel and ferry services are complements for at least a portion of the freight market.
144. Eurotunnel may therefore be able to leverage its assured base by offering a rebate on the Eurotunnel contingent upon purchasing ferry services. The data presented to the OFT indicates that Eurotunnel would have to offer a significant discount on its train services in order to prevent rival ferry operators from being able to match the bundled discount. The volume discounts in the freight market incentivise customers to purchase from a relatively small number of providers, meaning that any bundling may be likely to further concentrate volume away from other ferry operators. Similar to above, this may lead to a reduction in the number of players in the market, enabling the remaining players to increase prices.
145. Ferry operators' marginal or variable costs vary with number of sailings, rather than passengers/freight. Thus, a reduction in the number of passengers or freight may lead to a reduction in frequency of sailings, and possibly exit from the market, enabling the remaining operators to increase prices.
146. Eurotunnel informed the OFT that tour operators make up a small proportion ([ ] per cent) of its volume and that it makes no financial sense to offer a significant rebate on its tunnel services, and therefore Eurotunnel

would not have the incentive to engage in a bundling strategy. Eurotunnel also submitted that the spare capacity amongst ferries and airlines means that there would be no scope for recoupment. Eurotunnel also notes the ability of rival ferry operators to bundle a Short Sea journey with a journey on another route.

147. The OFT did not consider it necessary to conclude on whether there is a realistic prospect that a bundling strategy will lead to a substantial lessening of competition given the OFT's conclusion on unilateral effects above.

### **THIRD PARTY VIEWS**

148. The OFT received comments from competitors, freight customers and also included in this case a pilot project aimed at eliciting views from passengers who it would be impractical to contact on an individual basis but who overall represent a significant proportion of customers. Through this exercise, the OFT received submissions from 15 customers.

149. Of the freight customers, a majority expressed concerns regarding the merger, including concerns relating to unilateral effects, partial foreclosure, bundling and predatory behaviour. Only two freight customers that responded to the OFT's enquiries did not have concerns relating to the Transaction.

150. Two freight customers noted that the ownership of both tunnel and ferry services will place Eurotunnel at a strategic advantage as against other ferry operators. Two freight customers also raised concerns relating to predatory behaviour by Eurotunnel, with one of those freight customers stating that a price war would likely emerge as a result of the Transaction, leading to a destabilisation the market.

151. All competitors that responded to the OFT's enquiries raised concerns relating to the Transaction. Most competitors raised concerns relating to unilateral effects and predatory behaviour, while approximately half of the competitors raised concerns relating to inter-availability agreements and bundling.

152. The majority of passengers that provided responses to the OFT as a result of the pilot project were concerned about the Transaction. Most of these concerns related to unilateral effects.

## **UNDERTAKINGS IN LIEU**

153. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

154. By way of undertakings in lieu of reference, Eurotunnel offered to, for a period of five years:

- continue to give effect to the inter-availability agreements which have already been signed (on their expiry to renew them on the same terms with a price increase according to inflation energy costs), and
- promptly enter into new inter-availability agreements on the same terms with any other ferry operator on the Short Sea which requests Eurotunnel to do so
- treat all ferry operators in a non-discriminatory manner which seek to invoke the inter-availability agreements
- ensure that there is no obligation on any Eurotunnel freight customer for tunnel transport services to purchase ferry transport services or vice versa.

155. As explained in the OFT's guidance,<sup>73</sup> in order to accept undertakings in lieu of reference, the OFT must be confident that all the potential competition concerns that have been identified in its investigation would be resolved by means of the undertakings in lieu without the need for further investigation. The need for confidence reflects the fact that, once undertakings in lieu have been accepted, this is final in terms of the OFT's

<sup>73</sup> OFT1122 Exceptions to the duty to refer and undertakings in lieu of reference guidance, December 2010.

ability to refer, as section 74(1) of the Act precludes a reference after that point.

156. The OFT has considered whether the undertakings offered by Eurotunnel would provide a clear-cut resolution of the concerns identified above. While the OFT welcomes the willingness of the parties to put forward remedies, it does not consider that the remedies proposed in this case are capable of operating in a clear cut way to remedy the competition concerns arising from the Transaction.

157. While the undertakings offered by Eurotunnel may address any potential partial foreclosure concerns resulting from the inter-availability agreements, they do not address the OFT's unilateral concerns as set out above. With regard to Eurotunnel's offer to ensure that the purchase of tunnel transport services is not tied to the purchase of ferry transport services or vice versa, the OFT notes that its potential concern relates to Eurotunnel offering customers a bundle, rather than requiring customers to purchase both tunnel and ferry transport together.

158. The OFT therefore believes that the undertakings offered would not remedy or prevent the adverse unilateral competition concerns identified and therefore the duty to refer remains.

## **ASSESSMENT**

159. Eurotunnel has acquired certain assets, formerly held by SeaFrance, out of liquidation from the French Commercial Court. SeaFrance went into liquidation in January 2012, following which Eurotunnel was declared to be successful in its bid for a collection of its assets. The assets that were transferred to Eurotunnel included three vessels suitable for Channel ferry crossings and various other tangible and intangible assets (including domain names and customer records).

160. The OFT considers that, taking into account the importance of the physical assets purchased to the operation of a ferry business, the goodwill associated with those assets and the fact that it had not dissipated despite the cessation of trading, and the fact that, through a series of arrangements with the SeaFrance SCOP, many of the same employees would be operating the vessels as under SeaFrance, it may be the case that enterprises ceased to be distinct as a result of the Transaction. The OFT considers it particularly relevant that two of the three vessels purchased

are specifically suited to the Short Sea, the SeaFrance web address is still active and automatically redirects customers MyFerryLink, and Eurotunnel attributed value to the customer records in the purchase price offered for the SeaFrance assets.

161. The OFT considers that the share of supply test is met because in 2011 Eurotunnel's share of supply in passenger and freight transport services across the Short Sea exceeded 25 per cent and SeaFrance had a share of supply of approximately eight per cent for passengers and 13 per cent for freight.
162. The OFT considers that, absent the merger, SeaFrance would have exited the market since it had ceased trading and been through a process of administration and then ordered into liquidation. However, the OFT considers that there may have been an alternative purchaser representing a better outcome for competition. The Court received bids from other ferry operators, both during SeaFrance's administration and liquidation. During liquidation, DFDS submitted a bid for two of the vessels which are now being operated by Eurotunnel on the Short Sea. The OFT has assessed the Transaction against two realistic alternative counterfactuals, namely a purchase by a new non-overlap bidder or a purchase by DFDS. In relation to both the OFT considers that they may have represented a better outcome for competition.
163. In line with previous decisions and responses from third parties, the OFT assessed the Transaction on the basis of freight and passenger transport services (including ferry services and Eurotunnel) across the Short Sea.
164. The OFT found that the combined shares of supply of Eurotunnel and SeaFrance were in excess of 50 per cent in the provision of passenger and freight transport across the Short Sea. The OFT considers that the balance of evidence indicates that Eurotunnel and P&O are the closest competitors in the provision of transport across the Short Sea, with SeaFrance being the second closest competitor. The Transaction would therefore lead to two strong players, P&O and an enlarged Eurotunnel and MyFerryLink, and a weaker third player, DFDS. On this basis, the OFT considers that the Transaction may give rise to unilateral effects in the form of price rises.
165. On the basis of shares of supply and closeness of competition, the OFT considers that if DFDS had been successful in acquiring the vessels, this

would have led to the presence of three strong players in the market. In the alternative, if a non-overlap operator had been successful in acquiring the vessels, this would have led to the presence of four players on the market. While the current Transaction resulted in a reduction of four to three players in the market, the third remaining player is relatively weak. Thus, as against either counterfactual, the Transaction may be expected to result in a substantial lessening of competition in the form of increased prices.

166. The OFT considers that there is spare capacity in Short Sea transport and has assessed whether this would allow rivals to easily accommodate considerable switching of demand by customers away from Eurotunnel in the event of a price rise. The OFT found, on the basis of the evidence, that the level of capacity available may not be sufficient relative to Eurotunnel volumes to prevent a price increase, especially in light of P&O's and Eurotunnel's capacity constraints at peak times.
167. The OFT considered whether there were any countervailing factors that would counteract its unilateral effects concerns. The OFT did not find evidence that entry or expansion would be timely, likely and sufficient to counteract the concerns identified, particularly in light of the fact that the key Dover port may have limited capacity to accommodate new entrants. The OFT considered the recent announcements made by Euroferries that it will launch a ferry service on the Ramsgate/Boulogne route in 2013 and by DFDS that it will alter the configuration of vessels currently operating on its Short Sea routes. The OFT, however, is not persuaded that these recent announcements are sufficient evidence of timely, likely and sufficient entry or expansion to prevent a substantial lessening of competition from arising.
168. The OFT also considered three non-horizontal theories of harm: partial input foreclosure resulting from the inter-availability agreements; facilitating predatory behaviour; and bundling. However, the OFT did not consider it necessary to conclude on whether there is a realistic prospect that such a strategy will lead to a substantial lessening of competition given the OFT's conclusion on unilateral effects above.
169. Consequently, the OFT believes that it is or may be the case that the Transaction has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## DECISION

170. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.