

Completed acquisition by Arriva plc of certain assets from K.M.P.
(Llanberis) Ltd

ME/3769/08

The OFT's decision on reference under section 22 given on 6 November 2008.
Full text of decision published 18 November 2008.

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

PARTIES

1. **Arriva Cymru Limited** (Arriva) is part of the bus business of Arriva North West Limited (known as Arriva North West and Wales) which is a wholly owned subsidiary of Arriva plc. Arriva plc is one of the UK's largest bus companies with operations in various locations throughout the UK.
2. **K.M.P. (Llanberis) Limited** (KMP) is a family run bus business in North Wales. KMP has a depot in Llanberis and operates 34 vehicles. KMP employs 28 drivers, three mechanics and five other employees. The annual turnover of KMP is around £2 million.

TRANSACTION

3. The acquisition by Arriva of certain assets of KMP completed on 3 August 2008. The assets acquired were:
 - seven buses

- the commercial bus service number 9A and 9B, which operate between Llandudno and Llangefni and between Llandudno and Caernarfon
 - the goodwill of the acquired assets, and
 - the commercial information related to the business.
4. In addition to these assets, five employees transferred to Arriva. Consequently the OFT considers that the acquired assets constituted an enterprise within the meaning of section 129 of the Enterprise Act 2002 (the Act).
5. The Office of Fair Trading's (OFT) statutory deadline for deciding whether to refer the merger to the Competition Commission (CC) is 3 December 2008. The OFT's administrative deadline expired on 22 October 2008.

JURISDICTION

6. As a result of this transaction Arriva and the enterprise acquired from KMP have ceased to be distinct. Pre-merger, the parties were the sole suppliers of bus services from Llandudno to Bangor and Bangor to Llangefni in north west Wales. The share of supply test in section 23 of the Act is therefore met (see endnote 1) and the OFT believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

Product scope

7. Both parties are active in the supply of bus services, which can be segmented between commercial and tendered or contracted¹ services. It is not uncommon for operators of commercial services to provide tendered services and, to a lesser extent, for operators of tendered services to provide commercial services. However, in past cases the OFT has taken the view that these two types of services have different characteristics and are not substitutes from a market definition standpoint.² Tendered services are subsidised by the local authority in order to provide transport services where it would otherwise be unprofitable for private companies to do so.

¹ Tendered and contracted services have similar characteristics and will be hereinafter dealt with together.

² OFT decision on the completed acquisition by Arriva plc of Premier Buses Limited, 1 June 2006.

Bus operators bid for tendered contracts, which are re-tendered every few years, and the local authority will, usually, specify the routes, the timing (or frequency) of services and the fares to be charged on those routes.

Competition in tendered services occurs at the bidding stage rather than in operating the service. The evidence before the OFT does not suggest that it would be appropriate to depart from this distinction in the present case.

8. The CC has previously considered the degree of substitutability between public and private transport and between different modes of public transport such as coach, train and tram.³ However, since the definition of the product scope does not alter the outcome of the OFT's competition assessment, the OFT has not found it necessary to conclude on it.

Geographic scope

9. When making a journey, passengers travel from a particular origin to a particular destination and therefore other origin/destination combinations are not likely to be substitutable from a demand-side perspective. The OFT and the CC have previously considered local markets in transport cases on the basis of the substitutability of competing services on point-to-point flows.⁴
10. The merging parties overlap in the provision of commercial bus services on the following flows: Llandudno-Bangor, Bangor-Caernarfon and Bangor-Llangefni.
11. The OFT has not been presented with evidence to convince it that supply-side substitution is likely or timely for these individual flows but nevertheless the constraint posed by other bus companies who might enter any of the three overlapping flows will be considered in the barriers to entry section below.
12. The OFT does not consider that it is necessary to define the appropriate frame of reference against which to assess the impact of the merger on

³ CC report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited, June 2004.

⁴ CC report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited, June 2004, OFT decision on the anticipated acquisition by FirstGroup plc of the Greater Western Franchise, 30 September 2005. A flow is a bus journey between specific start and end points, which may be all or part of a longer bus route.

tendered services since it does not affect the outcome of the OFT's competition assessment.

Conclusion

13. Since the merging parties overlap in the provision of commercial services, the OFT has focused its assessment on the impact of the merger on commercial bus services. However, whenever relevant, the competitive constraint provided by the existing tendered services on the commercial services of the merging parties is also considered.
14. The OFT has examined this merger on the basis of the supply of commercial bus services on each flow in which the parties overlap, which comprise the Llandudno-Bangor flow, the Bangor-Caernarfon flow and the Bangor-Llangefni flow.

HORIZONTAL ISSUES

Llandudno-Bangor and Bangor-Llangefni

15. The merging parties are the only two operators providing bus services on the whole of the Llandudno-Bangor and Bangor-Llangefni flows. The transaction will therefore create a monopoly on travel to the end points of those flows. The merging parties compete with other providers of bus services, namely Padarn and Lewis y Llan, on parts of those flows, although they remain the largest competitor on any given part of the flow with the lowest combined market share of 65 per cent⁵.

Bangor-Caernarfon

16. The merging parties compete with Express Motors on the whole of the Bangor-Caernarfon flow and with Lewis y Llan and tendered services of KMP (which are not part of the transaction) on a part of that flow. However, Arriva was the largest competitor on any given part of this flow

⁵ The market share is calculated in terms of the hourly service frequencies for each segment of each flow. Given that a number of operators serve different segments of each investigated flow with services provided either on that particular segment of the flow or on a different flow which on that particular segment overlaps with the investigated flows, the market share of the merging parties varies along each flow.

prior to the merger and this position was further reinforced following the merger with the lowest combined market share of 77 per cent.

Differences between the parties' services

17. There is some doubt as to whether the merging parties' services are close substitutes. On the Llandudno-Bangor flow, Arriva's services stop in eleven places, while KMP's services only stop in eight places. The merging parties also take a different route to Llandudno from Llandudno junction. For example, a stop outside a hospital in Craig y don (near Llandudno) is only serviced by Arriva. The OFT understands that Arriva's customers consider having access to the hospital using a bus service to be important.
18. As a result of these differences, the Arriva service takes approximately 20 minutes longer to travel between Llandudno and Bangor than the KMP service, which is reflected in the reference by the merging parties to the KMP service as 'express'. Differences in service were also noted by consumers who submitted their comments to the OFT, with some noting that, for example, KMP's punctuality is far superior to Arriva's. These differences are also reflected in price, with Arriva's fares generally being significantly higher than KMP's fares.
19. Following KMP's entry on the Llandudno-Bangor flow four years ago, Arriva altered neither its fares nor its service frequency. The OFT understands that this is contrary to other instances in the Bangor area where Arriva adjusted prices and/or service frequency in response to entry by a competitor. As such, there is some doubt as to whether KMP provided an effective competitive constraint on Arriva pre-merger on the basis of these differences in the parties' services, and lack of discernible impact on Arriva when KMP entered the market. Nevertheless, the OFT considers that it is still possible that KMP was constrained by Arriva (rather than vice versa), and that this loss of constraint could lead to a significant lessening of competition. This is discussed in the following section.

Changes since the merger

20. In this particular case, certain changes have already been made to the parties' services post-merger. Prior to the merger, Arriva and KMP operated seven buses per hour on the Llandudno-Bangor flow (Arriva four, KMP three), three buses per hour on the Bangor-Llangefni flow (Arriva two, KMP

one), and six buses per hour on the Bangor-Caernarfon flow (Arriva four, KMP two).

21. Following the merger, Arriva has maintained the three buses per hour on the Bangor-Llangefni flow and the six buses per hour on the Bangor-Caernarfon flow, as well as the express service previously run by KMP on the Llandudno-Llangefni route. On the Llandudno-Bangor flow, however, Arriva has reduced the number of buses per hour from seven to four, advising that four buses are sufficient to service the Llandudno-Bangor flow. Further, Arriva has aligned the pricing on the former KMP services with its own pricing, which has entailed implementing various price increases on the services formerly run by KMP.
22. In light of the above evidence, the OFT considers that it is possible that Arriva did provide a competitive constraint on KMP which was removed by the merger, evidenced by the price increases and frequency reduction on the former KMP services following the acquisition.

Barriers to entry and expansion

23. As the CC pointed out in its '*Review of methodologies in transport enquiries*' report (the CC methodology report), the extent to which the parties could raise fares or reduce services on overlap flows or routes after the merger is subject to the prospects for entry and expansion of existing operators on those flows or routes.⁶ The CC methodology report further notes that a merger itself may also increase barriers to entry and expansion, for instance through the increase in the size of the network.
24. The merging parties submitted that, in line with past OFT decisions, barriers to entry were low. Competitors' views on the ease of entry or expansion were mixed. Some advised that, at least in theory, they would be able to expand easily into the overlap areas and operate in competition with Arriva, while others advised that, in practice, Arriva was a strong competitor that they would think carefully about competing against.
25. In this case, the combination of evidence of previous successful entry or expansion by Arriva's competitors in north Wales and specific evidence of a third party's intentions to enter onto the overlap routes has enabled the

⁶ Competition Commission, *Review of methodologies in transport enquiries*, para 70.

OFT to conclude that entry will be timely, likely and sufficient to address any potential substantial lessening of competition arising in this case. This conclusion is based on the following evidence:

26. First, there have been examples of successful entry and expansion against Arriva in the past. Arriva has competed against a number of similarly sized or larger competitors in north west Wales and, specifically, in the Bangor area. These competitors, including, among others, KMP, Padarn and Express Motors, have successfully entered and expanded against Arriva in the past ten years.
27. Second, KMP advised that its operations on the overlap routes are profitable and the rationale for selling these routes is because its owners wish to retire. In other words, there is no reason to consider that potential entrants would be disincentivised from entering these routes due to concerns over profitability. In addition, the OFT notes that any new entrant on the Llandudno-Bangor flow would face exactly the same number of Arriva services that KMP did when it entered four years ago.
28. Third, there has already been some third party expansion since completion of the merger. Specifically, one competitor, Express Motors, increased its frequency on the Bangor-Caernarfon flow, where it competes against Arriva. Arriva has also previously competed against Express Motors on the Porthmadog-Pwllheli flow, and in that case Arriva exited after only a short time.
29. Fourth, the OFT understands that another competitor, Padarn, is about to complete the acquisition of the rest of the KMP business.⁷ This acquisition is likely to strengthen Padarn as a potential competitor to Arriva, providing it with 27 additional buses and a bus depot in Llanberis (near Bangor). Given that Padarn is similar in size to KMP prior this transaction, the OFT considers the acquisition of the rest of KMP is likely to significantly reinforce Padarn as a potential competitor to Arriva.
30. Finally, the OFT received specific evidence that [] intends to expand onto the Bangor-Caernarfon and Llandudno-Bangor flows in the near future. []

⁷ The terms of the transaction are agreed. Padarn is currently trying to raise funds. The deal should be finalized by December 2008.

also told us that it would consider entry on any other flows that Arriva currently services if a good economic case could be made for such entry.

THIRD PARTY VIEWS

31. The OFT received comments from four customers concerned about the changes in frequency, inconvenience that the merger will create for some passengers, increase in fare prices or the quality of Arriva's services. The OFT also received comments from three competitors concerned about the difficulty of entry against Arriva and the general difficulty of competing against Arriva, including Arriva's alleged tendency to predate on its competitors.⁸

ASSESSMENT

32. The merging parties overlap in the provision of commercial bus services on three flows in North Wales: Llandudno-Bangor, Bangor-Llangefni and Bangor-Caernarfon.
33. Post-merger, Arriva is currently the only provider of bus services to the end points of the flow on the Llandudno-Bangor and Bangor-Llangefni flows, and has a market share on parts of all three overlap flows ranging from 65 per cent to 100 per cent.
34. While there is some doubt over the extent of competition between the parties on the overlapping flows pre-merger due to several – in some cases significant - differences in each party's services (in particular, journey time and price), the OFT cannot exclude that the merger has had an adverse impact on the services provided by Arriva post-merger, including some price rises (as a result of Arriva aligning KMP's prices to those of its own) and some service reductions.
35. However, the OFT considers that barriers to entry and expansion in this particular case are low. Furthermore, one firm, Express Motors, has recently expanded its services on one of the overlap routes and another, [], is planning to enter or expand on the other two overlap routes in the near future. [] The OFT therefore considers that the combination of low barriers to entry, the existence of a number of equally sized or larger

⁸ For example, by increasing the frequency of service in response to new entry.

potential competitors (than that of KMP), and specific evidence of actual expansion post-merger from one competitor, and of intentions to enter from another competitor is sufficient to address any potential substantial lessening of competition arising from the merger.

36. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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

ENDNOTES

1. The share of supply test is satisfied on the basis that the parties overlap in the supply of bus services in North Wales and will have a post-merger share of supply of over 64 per cent.