
Completed acquisition by McGill's Bus Services Limited of Arriva Scotland West Limited

ME/5323/12

The OFT's decision on reference under section 22(1) given on 18 April 2012. Full text of decision published 22 May 2012.

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

PARTIES

- 1) **McGill's Bus Services Limited (McGill's)** is a commercial local bus operator with services in the Inverclyde and Renfrewshire areas of Scotland. It entered the bus market in 2001 when it acquired bus operations in the Inverclyde area from Arriva Scotland West and expanded into the Renfrewshire area in 2008 through organic growth. For the Renfrewshire and East Renfrewshire areas, McGill's has one depot in Barrhead. In the year ended 31 December 2010, McGill's achieved turnover of £11 million, approximately half of which was earned in the Renfrewshire and East Renfrewshire area.
- 2) **Arriva Scotland West limited (Arriva)** is a wholly owned subsidiary of Arriva (2007) Limited, wholly owned by Deutsche Bahn AG. Arriva's bus operations are in the area of Renfrewshire and East Renfrewshire where it has two depots at Johnstone and Inchinnan and approximately 160 buses in service. In the year ended 31 December 2010, Arriva earned revenues of £17.9 million.

TRANSACTION

- 3) On 13 December 2011, McGill's and Arriva signed a business sale agreement under which McGill's would purchase Arriva's assets and

goodwill in Glasgow and Renfrewshire. These assets include the two depots at Johnstone and Inchinnan, approximately 160 buses run from those depots, and 380 employees transferred under TUPE. The consideration paid is £[]. The Arriva brand name remains with Arriva.

- 4) The parties state that the merger will give McGill's an opportunity to grow and expand its operations in Glasgow and the surrounding areas, particularly Renfrewshire and East Renfrewshire.
- 5) The merger completed on 26 March 2012.
- 6) The merger was identified by the OFT's mergers intelligence function. The OFT's administrative deadline for deciding whether to refer the merger to the Competition Commission (CC) is 6 April 2012 and the statutory deadline is 25 July 2012.

JURISDICTION¹

- 7) The OFT considers that the transaction has resulted in two or more enterprises ceasing to be distinct under section 23(1) of the Enterprise Act 2002 (the Act).
- 8) In the year ended 31 December 2010, Arriva earned revenues of £17.9 million. Therefore, the turnover test contained in section 23(1)(b) of the Act is not satisfied.
- 9) The parties overlap in the provision of commercial local bus services in the area of Renfrewshire and East Renfrewshire, of which Paisley is the main urban area.
- 10) The parties submit that the geographic overlap between the parties is insufficient to constitute a 'substantial part of the UK', for the purposes of the share of supply test under section 23(4) of the Act.

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

- 11) The OFT has considered the definition of a 'substantial part of the UK' given by the House of Lords in *R v Monopolies and Mergers Commission and another; ex parte South Yorkshire Transport Limited* ('ex parte South Yorkshire'), which involved the merger of two local bus companies in South Yorkshire. The House of Lords considered that the definition of a 'substantial part of the UK' required that an area or areas must be considered of such size, character and importance as to make it worth consideration for the purposes of merger control.²
- 12) The OFT notes that in the Stagecoach/Preston Bus case, the OFT and CC both found that a population of 131,000 and a geographic area of approximately 144 square kilometres were sufficient to constitute a substantial part of the UK.³
- 13) In the context of the current transaction, the OFT notes that the population of Renfrewshire and the geographic area covered exceed that of Preston. The area of Renfrewshire has a population of approximately 170,000 and the geographic coverage of the area is

² In that case, Lord Mustill stated that: '...where the task is to interpret an enabling provision, designed to confer on the commission the power to investigate mergers believed to be against the public interest the court should lean against an interpretation which would give the commission jurisdiction over references of the present kind in only a small minority of cases. This is the more so in the particular context of local bus services, since the provision of adequate services is a matter of importance to the public, as witness the need felt by Parliament to make special provision for them in the Transport Act 1985' [1993] 1 ALL ER 289.

³ ME/4032/09, OFT decision completed acquisition by Stagecoach Group plc of Preston Bus Limited, 28 May 2009, paragraphs 8 to 11; and Competition Commission, Stagecoach Group plc/Preston Bus Limited Merger Enquiry, a report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009, paragraphs 3.11 to 3.14.

195 square kilometres.⁴ The OFT considers this to be sufficient to constitute a 'substantial part of the UK' for the purposes of the share of supply test under section 23(4) of the Act in this case.

- 14) The parties are both active in the UK in the supply of local bus services in the area of Renfrewshire and East Renfrewshire, including Paisley. The OFT considers that the merger qualifies for investigation on the share of supply test, with the parties together supplying more than 69 per cent of local bus services in the local authority area of Renfrewshire. Consequently, the share of supply test in section 23(4) of the Act is satisfied.

BACKGROUND

- 15) The OFT and CC have each considered the provision of local bus services on a number of occasions, including in the context of recent merger investigations.

- On 18 September 2008, the OFT decided not to refer the completed acquisition by Stagecoach Bus Holdings Limited of Cavalier Contracts Limited to the CC on the basis that the market concerned was of insufficient importance to justify a reference.⁵

⁴ The Renfrewshire Local Transport Strategy 2007 notes: 'Renfrewshire Council is a predominantly urban area containing 784 km of roads and a population of 170,611 contained in 80,590 households (2004 figures). The main strategic road (A737 and M8) and rail links connecting Glasgow to Ayrshire and Glasgow to Inverclyde pass through the heart of Renfrewshire. Paisley sits as the hub town surrounded by towns, villages and employment centres spread throughout the area. Glasgow Airport, which is located to the north of Paisley currently carries 8 million passengers annually'.

(See www.renfrewshire.gov.uk/ilwwcm/publishing.nsf/Content/Navigation-pt-TransportPlanningHomepage.)

⁵ ME/3703/08, OFT decision completed acquisition by Stagecoach Bus Holdings Limited of Cavalier Contracts Limited, 18 September 2008.

- On 13 May 2009, the OFT referred the completed acquisition by Stagecoach of Eastbourne Buses Limited and Cavendish Motor Services to the CC.⁶
- On 28 May 2009, the OFT referred the completed acquisition by Stagecoach Bus Holdings Limited of Preston Bus Limited to the CC.
- On 23 December 2009, the OFT decided not to refer the anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited to the CC on the basis that the market concerned was of insufficient importance to justify a reference.⁷
- On 7 January 2010, the OFT referred the supply of local bus services to the CC for investigation and report.⁸
- On 20 December 2011, the CC published the results of its local bus services market investigation.⁹ The report concludes, inter alia, that: '[] ongoing sustained head-to-head competition, where present, delivers significant benefits to customers.'¹⁰

⁶ ME/4030/09, OFT decision completed acquisition by Stagecoach Bus Holdings Limited of Eastbourne Buses Limited and Cavendish Motor Services, 13 May 2009.

⁷ ME/4290/09, OFT decision anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited, 23 December 2009.

⁸ www.offt.gov.uk/OFTwork/markets-work/references/bus-services.

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

¹⁰ CC Local bus services report, paragraphs 2 and 4.

COUNTERFACTUAL

16) The parties submit that changes to the bus subsidies regime and the quality and service requirements imposed on bus operators in Scotland, coming into effect in 2012, should be taken into account in the OFT's assessment. In particular the parties referred to:

- changes to the subsidies given to Scottish bus operators for fuel rebates and concessionary fares; these, the parties argue, are likely to result in reductions in service frequencies as operators try to manage a significant reduction in their funding (with implications for cash flow at certain times of the year), and
- significant investment required for the Arriva fleet to meet higher quality service standards and Disability Discrimination Act (DDA) requirements.

17) In line with the Merger Assessment Guidelines, the OFT notes that future changes in market conditions, such as regulation, are usually addressed as part of the competitive assessment (see below at paragraphs 78) to 81)).¹¹

18) Furthermore, the OFT notes that the parties have not sought to argue that the Arriva business should be considered as a 'failing firm' (in that it would inevitably exit the market absent the merger), nor that there could have been no other purchasers for the Arriva business in the absence of the acquisition by McGill's. Although the parties did argue that the Arriva business would have been impacted by the regulatory changes detailed in paragraph 17) above, they did not provide specific and compelling evidence that, absent the merger, Arriva would have discontinued certain specific routes or shrunk the business in a particular way. Therefore, the OFT does not consider that McGill's is acquiring assets, goodwill and personnel that would, in any event, have exited from the market such that the

¹¹ OFT 1254, CC2 (Revised), Merger Assessment Guidelines, September 2010, paragraph 4.3.2.

OFT could adopt a different counterfactual to the pre-merger situation.¹² Indeed, the OFT notes that Arriva was profitable last year even though its margins were small.

- 19) In light of this, the OFT considers it appropriate to consider the merger against the prevailing conditions of competition and to take into account the regulatory changes, as highlighted by McGill's, in its competitive assessment further below to the extent that this is appropriate.

MARKET DEFINITION

Product scope

- 20) The parties overlap in the provision of local commercial bus services.¹³ The parties have indicated that the vast majority of routes operated by them are operated on a commercial basis, with 99 per cent of McGill's routes and 95 per cent of Arriva's routes being commercial services. As neither McGill's nor Arriva provide a significant number of tendered bus routes (as tendered by local public authorities), this activity is not considered further.
- 21) The parties submit that other forms of transportation, including private cars, taxis and the train, should be included in the definition of the relevant product market.
- 22) The OFT takes note of the CC's bus services report which states that, generally, the evidence does not suggest that other modes of transport constitute a competitive constraint on bus operators:

¹² OFT 1254, paragraph 4.3.9.

¹³ The Transport Act 1985 defines a local bus service as a service using one or several public service vehicles to carry passengers at separate fares where the distance between stopping places or overall journey length is less than 15 miles (24 km) in a straight line (CC Local bus services report, paragraph 2.1).

‘Customers may have a choice between alternative modes of transport to complete their journey. Many of the operators and other parties such as LTAs said that, in particular, the car was a competitive constraint on bus operators. However, the evidence did not support their view. We found that not enough passengers would switch to other modes of transport in response to small changes in the competitive variables, such as fares, for this to act as a competitive constraint which would warrant widening the relevant market.’¹⁴

- 23) Consequently, and given that the OFT has received no evidence in this case that would suggest otherwise, the OFT does not consider that it should include the constraint from private cars or taxis within the relevant market. The OFT is also mindful in this case that the areas of Renfrewshire and East Renfrewshire have a higher than average number of residents who have no access to cars, compared to the general population of Scotland.
- 24) In terms of substitution to trams or trains, however, the CC reports notes that rail and tram services can offer an alternative to bus travel on some specific point-to-point journeys, where bus, train and tram overlap.¹⁵
- 25) Having regard to the above, the OFT considers that the relevant product market is the supply of commercial local bus services. In the competitive assessment below, the OFT has, where appropriate, considered the competitive constraints exercised by trains, in

¹⁴ CC Local Bus Services report, paragraph 20 and paragraphs 6.144 ff.

¹⁵ CC Local Bus Services report, paragraph 7.52.

particular in relation to the flows¹⁶ in the Paisley – Cardonald – Glasgow Central route.

Geographic scope

At the disaggregate level (flow by flow)

- 26) In line with previous OFT and CC merger reviews (see paragraph 15) above), the OFT has in this case considered the impact of the merger at the disaggregate level (that is, on a flow by flow basis on the flows where the parties currently overlap).
- 27) The parties overlap on certain flows of commercial local bus services in Renfrewshire and East Renfrewshire. In Renfrewshire and East Renfrewshire, McGill’s operates nine routes and Arriva operates 17 routes. None of the routes operated by McGill’s overlap entirely with routes operated by Arriva, although there is some partial overlap (see below).
- 28) Paisley is the main town in the area. A number of flows that form part of the competitive analysis of this transaction run through the centre of Paisley. This is assessed in more detail below. Both parties operate services between Paisley and Glasgow city centre. First also operates bus services on this route, while there is a train service operating between Paisley (Gilmour Street and Paisley Canal) and Glasgow central station.

At the aggregate level (network)

- 29) In Stagecoach/Preston Bus and Stagecoach/Eastbourne Buses, as well as looking at specific flow overlaps, the OFT also aggregated

¹⁶ A ‘flow’ is defined as a particular journey between start and end points. A flow may constitute an entire bus route or it may be only part of a longer route. Flows cannot always be fully distinguished from those routes of which they are a part, given that decisions on frequencies and fares are to some extent taken on the basis of routes as a whole. Furthermore, flows can be part of more than one route, particularly on ‘main corridors’ (main roads where a number of routes converge).

them for the purposes of its competitive assessment, to encompass both overlapping and non-overlapping flows served between the parties.¹⁷ The reason for aggregating individual flow-specific markets in this way is because the parties' route networks overlap extensively, with many routes running on (or close to) the other. The OFT explained the reasoning behind this aggregation as being that:

'Many routes of one party ran on, or close to, those of the other. Even on flows where the parties did not therefore directly overlap, in many instances it appears that it would have been relatively easy for the parties to alter or add to existing services to compete head-to-head with each other (for example, by extending or altering an existing route's path), thereby imposing an effective constraint on each other's behaviour ... In the OFT's view, this ease of supply-side reaction would therefore imply a series of separate flow 'markets' in which both parties are considered to be participants (even though only one is currently active in them).'¹⁸

30) Similarly, the CC in its recent bus report noted that:

'We found that there were three categories of competition between bus operators: head-to-head competition []. Potential competition, the constraint on incumbent operators from the threat that nearby rivals might redeploy or expand their existing services and start competing head-to-head. Potential competitors are operators with existing services and facilities in

¹⁷ ME/4032/09, paragraphs 19 to 20, and ME/4030/09, paragraphs 13 to 15.

¹⁸ ME/4032/09, paragraph 20.

or near the incumbent's area of operation. And new entry []'.¹⁹

- 31) Maps of McGill's and Arriva's networks pre-merger suggest that there is significant overlap in the parties' networks of routes, extending to Renfrewshire and a significantⁱ part of East Renfrewshire, with Paisley as its commercial centre and transport hub. One local authority estimated that the parties' networks overlapped by as much as 80 per cent.

Conclusion

- 32) The OFT considers that the relevant market for consideration is commercial local bus services in the areas of Renfrewshire and East Renfrewshire. The OFT has considered the effect of the merger in terms of the loss of actual competition on the flows on which the parties currently overlap as well as considering the effects of the merger at a wider level in terms of the loss of potential competition in the wider Renfrewshire and East Renfrewshire area.

COMPETITIVE ASSESSMENT – UNILATERAL EFFECTS

Actual competition

- 33) In its local bus services report, the CC found that competition between local bus operators is a greater constraint than other constraints, such as trains or trams, and that head-to-head competition drives beneficial outcomes for customers, leading to

¹⁹ CC, Local bus services report, paragraph 26. The CC noted in the report that 'A route-level analysis, focusing on single point-to-point trips, may miss important aspects of how a given route—and the number of services run on that route—fits into the overall network. Also, operators may not set prices at the route level since customers may find price differences between routes in their area inconvenient or confusing and may choose to avoid this complication by not going by bus. Some of the effects of concentration, or conversely competition, may thus arise only in a network of neighbouring routes' (Annex 7, paragraph 47).

higher frequency of service, lower fares in the long term and improvements in service quality.²⁰

- 34) The OFT notes that the CC found, however, that head-to-head competition is uncommon, in part because of the ease with which operators can negatively target competitive activity.²¹ The findings of the CC in its local bus services report demonstrate that it is important for the OFT to examine carefully transactions where the merger gives rise to a loss in actual head-to-head competition between the parties on existing flows.

Filtering approach

- 35) In their review of Stagecoach/Preston Bus and Stagecoach/Eastbourne Buses, the OFT and CC considered the competitive constraints on a flow-by-flow basis in order to determine whether the merger may provide an incentive to increase fares or reduce service levels.
- 36) In most transport inquiries there can be large numbers of overlap flows. In order to focus the analysis on those areas that are most likely to give rise to competition concerns, the CC developed a filtering approach to the overlaps in order to screen out overlap flows that are unlikely to be considered problematic. The CC sets out the following three filters:²²
- **The relative importance of overlapping flows:** it is only worthwhile for the parties to adjust fares and/or reconfigure routes post-merger if the overlap flows on the route account for a significant proportion of total route revenue. The CC has in

²⁰ CC report, paragraph 8.7. and 8.8.

²¹ Other reasons which restrict head-to-head competition, according to the CC report, include consumer behaviour, within-route network and ticketing effects and transparency within the industry. See CC report, paragraphs 27 and 8.99.

²² CC, Review of methodologies in transport enquiries, 2006, paragraphs 25 to 29.

many cases chosen to exclude from initial analysis those routes for which overlaps account for less than 10 per cent of passengers and revenue.

- **Countervailing competition:** Flows that are the subject of countervailing competition from third parties could be filtered out of the analysis. This could include considerations whether a competitor offers a comparable frequency of service. The appropriate definition of an effective competitor differs depending on the geographic characteristics of the flows or routes.
- **De minimis:** Flows of relatively little importance, in terms of either revenue, number of passengers or frequency of service, can also potentially be excluded from the initial stages of analysis (this is further discussed at paragraphs 93) to 103) below).

- 37) The OFT has taken account of the relative importance of overlap flows in its competitive assessment, below. However, the OFT is mindful in this case that the number of actual overlap flows involved is relatively limited, to some extent removing the need for filtering. Furthermore, as noted in previous cases,²³ these filters should not be viewed as safe harbours and, in particular where a transaction results in only one operator on a given route, as is the case on some flows in the current transaction, further analysis may be required.
- 38) Detailed revenue for each overlap flow and corresponding routes was not made available to the OFT.²⁴ However, McGill's advised that three of the 13 overlap flows (Paisley town centre, Paisley to Renfrew and Paisley to Linwood) account for less than 10 per cent of the revenues for the corresponding routes such that they should – in line with the CC's filtering approach discussed above – not be

²³ ME/4032/09, paragraph 15.

²⁴ The OFT requested detailed revenue for each overlap flow and corresponding routes from the parties but was only given information as to which overlap flow revenues were worth less than 10 per cent of the corresponding route revenues.

considered to raise concerns.²⁵ However, one of these overlap flows is an overlap where the transaction effectively creates a merger to monopoly: Paisley to Renfrew.²⁶ Another flow (Paisley town centre) is one in which the parties' services operating on that flow also operate on other affected flows.²⁷ The OFT considers that whilst the revenues earned on the Paisley town centre overlap flow may be less than 10 per cent of the revenues earned on the corresponding routes, the revenues earned on all four overlap flows are likely to exceed 10 per cent of the revenues earned on the corresponding routes.²⁸ As such, the OFT does not consider it appropriate in this case to apply the 10 per cent filter such as to remove two of these three flows from its competitive assessment.²⁹

Competitive assessment

39) Pre-merger, the parties operated commercial local bus services in the Renfrewshire and East Renfrewshire areas. None of the routes operated by the parties overlap in their entirety (that is, along the whole route). However, 13 overlap flows are identified, 10 of which originate in the town of Paisley. These flows are summarised in Table 1 below.

²⁵ Frequencies on competing services are generally comparable.

²⁶ The parties submit that First operates across this flow but evidence available to the OFT does not support this: see paragraph 45) below.

²⁷ McGill's service 38, and Arriva's service 38, operate both across the Paisley town centre overlap flow and three other overlap flows (Paisley to Cardonald, Paisley to Glasgow city centre (via Bellahouston), and Paisley to Linwood Toll),

²⁸ McGill's did not provide the OFT with sufficient data to test this hypothesis.

²⁹ The OFT has not had to decide upon application of the 10 per cent filter to Paisley to Linwood given that the OFT did not find that competition concerns arose on this flow because of the presence of competing, comparable frequency operators.

Table 1: Summary of overlap flows

Overlaps	Distance ³⁰	Direct, comparable frequency competitors	Effect of the merger	Parties' additional arguments on why no concerns
Paisley town centre	½ mile	Riverside Transport, First	4 to 3	Flow below 10 per cent of route ³¹
Paisley to Renfrew	4 miles		2 to 1 ³²	Indirect First service Flow below 10 per cent of route
Paisley to Braehead	5 miles		2 to 1	First service (albeit less frequent) ³³
Paisley to Gallowhill	2 miles		2 to 1	Slaemuir Coaches (albeit less frequent) ³⁴

³⁰ The distance is estimated and rounded up.

³¹ The OFT also notes that the length of this flow is relatively limited. In the CC's bus report, it had regard to the length of an overlap route given that it found that very short overlaps are less likely to impose a constraint on the operator which runs the route (see paragraph 64 of Appendix 7.1).

³² The parties submit that First operates across this flow but evidence available to the OFT does not support this (see paragraph 45) below).

³³ First runs only two buses an hour through the week (except Saturday peaks when this increases to three buses/hour).

³⁴ Slaemuir Coaches runs one bus/hour in the evening for SPT.

Overlaps	Distance³⁰	Direct, comparable frequency competitors	Effect of the merger	Parties' additional arguments on why no concerns
Paisley to Cardonald ³⁵	5 miles	First	3 to 2	Scotrail service (albeit less frequent) ³⁶
Paisley to Glasgow City Centre (via Bellahouston) ³⁷	9 miles	First Scotrail	4 to 3	
Erskine to Braehead (via Renfrew)	7 miles		2 to 1	Differentiated McGill's and Arriva services ³⁸ Potential constraint from First
Paisley to Barrhead	5 miles		2 to 1	
Paisley to Nethercraigs	2 miles	Key Coaches	3 to 2	
Paisley to Foxbar	3 miles		2 to 1	
Paisley to Linwood (Toll)	3 miles	Riverside Transport, First	4 to 3	Flow below 10 per cent of route
Renfrew to Erskine	6 miles		2 to 1	Potential constraint from

³⁵ Trains from two train stations in Paisley, Paisley St James and Paisley Gilmour Street, run to Cardonald and on to Glasgow Central.

³⁶ Scotrail operates a (twice hourly) train service between Paisley and Cardonald.

³⁷ Additional trains to Glasgow Central run from Paisley Canal, a third station in Paisley, although there is no station at Bellahouston itself. Paisley Gilmour Street and Paisley Canal are approximately one mile apart from each other.

³⁸ The parties note that the profile of the services on the wider routes are very different and that the prices charged for this flow differ between the parties. Against this, the OFT notes that the parties are the only two operators actually competing on this flow.

Overlaps	Distance ³⁰	Direct, comparable frequency competitors	Effect of the merger	Parties' additional arguments on why no concerns
				First
Renfrew to Govan (via Braehead)	5 miles	First	3 to 2	

Source: the parties, OFT analysis.

40) The OFT considered each of the individual overlap flows above. In doing so, it has taken account of:

- the comparable frequencies (including start and finish times) of the parties' services on these flows
- the presence or otherwise of competitors on the flow, and the effectiveness of the competitor in question judged by pricing, frequency and duration of travel, and
- prices charged by the merging parties (and competitors) on the flow in question, where this is available.

41) provides information on the effect of the transaction in relation to the 13 flows on which both parties are active in the provision of local bus services in the area of Renfrewshire and East Renfrewshire. The OFT notes that the merger leads to a reduction in the number of bus operators providing head-to-head competition on a number of existing parts of routes, removing an important competitive constraint from the remaining operators which may allow them to reduce frequencies and/or raise prices to the detriment of bus passengers. In particular:

- On certain flows³⁹ the merger will reduce the number of operators providing direct and comparable frequency services from two to

³⁹ Paisley to Renfrew, Paisley to Braehead, Paisley to Gallowhill, Erskine to Braehead (via Renfrew), Paisley to Barrhead, Paisley to Foxbar, and Renfrew to Erskine.

one, leaving passengers with only one bus operator.

- On a further number of flows, the merger will result in a reduction in the number of operators providing direct and comparable frequency services from three to two.⁴⁰
- In relation to three flows, there will remain three or more alternatives (including rail) following the merger in terms of operators providing direct and comparable frequency services.

Closeness of competition

42) On the basis of the overlaps presented above, the OFT has gone on to consider the extent to which the parties should be considered to be close competitors in relation to their existing overlap flows. In this respect, the parties stated that their networks are not of a similar size and density. They provided some information that, in the Glasgow area:

- in terms of routes, Arriva ran 17 and McGill's nine routes
- Arriva operated 160 buses and McGill's operated 80 buses, and
- in terms of turnover, McGill's estimates for 2011 that Arriva's turnover was around £15 million and McGill's was £15.6 million.

43) However, in considering the evidence on closeness of competition in terms of network and operations, the OFT notes that:

- the parties operate significantly more buses than their smaller competitors,⁴¹ and significantly more routes in Paisley and Renfrewshire than any other competitor in the area

⁴⁰ Paisley to Cardonald, Paisley to Nethercraigs, and Renfrew to Govan (via Braehead).

⁴¹ For a definition of large operators (as opposed to small operator), see CC report, paragraph 6.9. On small, non-municipal bus operators, see CC report, paragraph 6.25.

- their hours of operation on routes in Renfrewshire are longer than their smaller competitors (and equal to First, a larger competitor, where it competes on certain routes)
- their services run more frequently than their smaller competitors (and equal to First, a larger competitor, where it competes on certain routes)
- the parties both offer multi-journey tickets (for the area of Renfrewshire and the rest of their respective networks) and
- the parties' networks are of similar size and are the only comprehensive networks that operate in these areas.

44) In terms of whether the parties are close competitors, the OFT also considered fares. The OFT notes that McGill's fares are generally cheaper than those offered by Arriva but more expensive than those set by smaller competitors (and, on occasion, First).⁴² This, the OFT considers, indicates that price competition takes place between the parties. The OFT also notes that a recent price announcement (which took effect on 26 March 2012) compares McGill's prices to Arriva rather than any of the other operators in the area, which could be regarded as indicative that the parties are particularly close competitors to each other.

Constraint from other providers

45) The parties highlighted the competitive constraint posed by direct rival bus services and the constraint from the train where it was of comparable frequency. In particular, they stated that:

⁴² Arriva increased its fares in January 2012. The OFT has no information about Arriva's fares prior to this.

- First offered indirect services which should be considered to act as a constraint on the parties⁴³ - however, the OFT did not regard this indirect service as a constraint given that the evidence available⁴⁴ indicated that it involved a significantly longer journey time and
- the presence of a competing Scotrail service – the OFT accepted the constraint from the Scotrail service should be considered where it was broadly comparable in terms of frequency and fares to the train,⁴⁵ but not where the services offered were materially less frequent (see also paragraph 24) above).⁴⁶

46) The parties also stated that First should be considered as a potential constraint on the parties' activities even where it was not present on a particular flow given the location of its depots.⁴⁷ However, the OFT was presented with no evidence to indicate the extent to which the parties' current operations were constrained by the threat of entry by First. Further, the OFT is mindful of the particular benefits of head-to-head actual competition, as found by the CC in its local bus services report.⁴⁸ As such, the OFT was not able to regard any constraint from First as sufficient in relation to the actual overlaps to remove any concerns given the level of concentration of actual competition.⁴⁹

⁴³ Relevant in relation to Paisley to Renfrew.

⁴⁴ First's website shows that this route is not a direct service and that passengers would need to travel from Renfrew to Braehead and change buses twice to get to Paisley.

⁴⁵ Relevant in relation to Paisley to Glasgow City Centre (via Bellahouston).

⁴⁶ Relevant in relation to Paisley to Cardonald.

⁴⁷ First has depots located in Larkfield and Scotstoun from which, they consider, they could serve the Renfrewshire and East Renfrewshire area.

⁴⁸ See CC local bus services report, section 8.

⁴⁹ Relevant in relation to Erskine to Braehead (via Renfrew) and Renfrew to Erskine.

Other arguments from the parties on actual competition

- 47) In relation to a number of overlap flows, the parties argued that the value of the overlap flow was less than 10 per cent of the value of the route – however, this filtering approach has been considered above (see paragraphs 37) and 38)).
- 48) The parties also argued that forthcoming regulatory changes would have had implications for Arriva’s operations had the merger not proceeded, the implication potentially being that the number of flows on which Arriva was active (or the frequency of Arriva’s operations on those flows) may have reduced absent the merger. However, the parties did not provide specific and compelling evidence that, absent the merger, Arriva would have discontinued certain specific routes or shrunk the business in a particular way (see paragraph 18) above). As such, the OFT has not been able to place weight on these assertions in the context of its assessment of the loss of actual competition.

Analysis and conclusion on loss of actual competition on existing flow overlaps

- 49) As detailed below (see paragraphs 85)ff), third parties were concerned about the effect of the merger, including in relation to frequency of routes. A number of respondents indicated that McGill’s and Arriva had been competing closely against each other.
- 50) The OFT is mindful that the CC’s local bus market report highlighted the importance of actual competition in local bus services, and the resulting benefits to passengers. The CC found that ongoing head-to-head competition can have an impact on operators’ pricing, and that operators monitor each other’s prices.⁵⁰ It also identified that operators responded to entry by improving service quality by introducing new vehicles, improving punctuality or reviewing and

⁵⁰ CC local bus report, paragraph 8.87.

modifying the network of routes offered in an area. The CC's statement that: 'in some instances, an improvement in service quality in response to head-to-head competition appears to be part of an operator's strategy to differentiate its services, and thereby sustain a presence on the route'⁵¹ is consistent with McGill's own explanation as to how it had invested in its fleet in order to win business.

- 51) On a number of overlap flows (Paisley to Renfrew, Paisley to Braehead, Paisley to Gallowhill, Erskine to Braehead (via Renfrew), Paisley to Barrhead, Paisley to Foxbar, and Renfrew to Erskine) the merger gives rise to a monopoly in terms of direct, comparable frequency competitors. The OFT considers that the merged entity will be unconstrained in terms of actual competition on these flows and that the threat of entry by another operator is insufficient to constrain it. On this basis, the test for reference is met on these flows.

- 52) On the three overlap flows where the merger reduces the number of effective, competing operators from three to two (Paisley to Cardonald, Paisley to Nethercraigs and Renfrew to Govan (via Braehead)), the OFT has considered the extent to which it believes competition will be reduced. On these flows, the OFT considers that the merger is likely to have removed the competitors that are closest to each other;⁵² it is also mindful that the parties have compared themselves against each other, and that they competed on fares and frequency. Taking due account also of third party concerns and the findings in the CC's local bus report on the significance of head-to-head competition, the OFT considers that the test for reference is met in relation to these flows also. The OFT notes that this is consistent with previous OFT cases in which mergers resulting in a

⁵¹ Ibid, paragraph 8.87.

⁵² The CC local bus report found (in paragraph 8.5) that the intensity of head-to-head competition between operators will depend on the similarity of their service, both in terms of the passenger flows they serve and the nature of the service offered on those flows, as this will determine the number of passengers who view them as substitutes.

reduction of competition from 'three to two' in local bus service operators have been found in some circumstances to give rise to competition concerns, specifically:

- in Stagecoach/Cavalier, the OFT considered that a reduction in the number of future independent operators on the Busway from three to two created a realistic prospect of a substantial lessening of competition, and
- in Stagecoach/Islwyn, the OFT found that the test for reference was met where the transaction reduced the number of bus operators on one flow from three to two.

53) On the three overlap flows where there will remain three or more effective competitors following the merger, the OFT considers that sufficient competition will remain to constrain the merged firm going forward such that competition concerns can be ruled out.

Potential competition

54) As well as assessing areas of actual overlap, the OFT also assesses potential competition, or supply-side reactions, between the parties. In the Renfrewshire and East Renfrewshireⁱⁱ area, the parties are the largest two operators of bus routes. The OFT notes that in terms of size, smaller incumbents do not reach the scale or network character of the parties.

55) The CC report notes that the nature of the bus industry is such that it is easy for an operator to observe a rival. From this it follows, that bus routes can be altered at short notice and that bus operators can add to, or amend, bus services in the face of actual or potential competition.⁵³

56) As noted above, the parties' networks overlap substantially, particularly around the town of Paisley. The OFT therefore

⁵³ CC bus report, paragraph 8.57.

considered whether or not the merger has removed a competitive constraint by virtue of removing the most likely potential competitor on flows where the parties did not overlap. As the Merger Assessment Guidelines note in relation to 'perceived potential competition':

'the merger may remove a firm which is not in the market, but which nevertheless imposes an existing constraint because of the threat that it would enter if existing firms in the market raised their prices. A constraint from such 'perceived potential competition' may arise even though the Authorities do not believe that entry would actually occur'.⁵⁴

- 57) In assessing 'perceived potential entry', the OFT has particular regard to the ease with which a potential entrant can enter into any routes or flows. If entry can take place without incurring substantial sunk costs, the likelier it is that the potential entrant exercises a competitive constraint on the incumbent.⁵⁵
- 58) In the present transaction, McGill's entered the market in 2008 in direct competition with Arriva and has expanded through six acquisitions made between November 2010 and June 2011 and through organic growth. The OFT notes that both parties operate comprehensive networks of frequent services and appear to engage in price competition. It is reasonable to consider that each party, when setting frequencies and fares, would have considered the desirability of pre-empting entry on their route by the other main incumbent in the Renfrewshire and East Renfrewshire region.⁵⁶
- 59) Turning to potential competition, the parties argued that, when the OFT is considering the threat of potential competition, it should take

⁵⁴ Merger Assessment Guidelines, paragraph 5.4.16.

⁵⁵ Merger Assessment Guidelines, paragraph 5.4.17.

⁵⁶ CC report, paragraphs 8.57 and 8.58.

account of the fact that First is of sufficient scale that it could compete against McGill's very easily on any of its existing routes. The OFT notes that First has two depots within three miles of Glasgow city centre. The OFT considered carefully the extent to which there was evidence that the merged parties would be constrained from the threat of entry by First onto the merged network going forward. In this respect:

- First provided the OFT with four examples where it had registered routes in competition with either McGill's and Arriva in the past three years, yet had subsequently to de-register and []. These examples tend to illustrate that First, notwithstanding its scale elsewhere, has not been an especially strong competitive force in the Renfrewshire and East Renfrewshire area.
- First advised the OFT that, hypothetically, it could enter the area in which the merging parties operate but would not currently do so in response to a small but significant increase in price. This, First argued, is because there is insufficient demand to make entry viable. Although the OFT is concerned with **perceived**, rather than **actual**, potential competition, it may be that McGill's would itself be able to anticipate First's view, in particular given the actual example of (largely failed) entry by First, discussed above.
- The parties have provided no direct evidence that either of them regarded First as a competitive constraint to date such that their prices and frequencies on their existing networks were constrained by the threat of entry by First.

60) In terms of other operators, Stagecoach advised that it has three routes that run in competition with the parties' routes (none of which feature in the list of 13 overlaps) and that, []. Neither of the other two smaller incumbent bus operators ([] or Key Coaches) []. Nor did the parties provide any evidence to indicate that they would be constrained by the threat of entry by any of these alternative operators, which is unsurprising given the significantly smaller scale

of Riverside Transport and Key Coaches compared to the merged party.

- 61) On the basis of the evidence available to it, the OFT is of the view that the merger removes a significant potential competitor at the level of the bus network in the area of Renfrewshire and East Renfrewshire. Even where the parties were not actually competing on the same routes or flows, they nonetheless exerted significant competitive constraints on each other through 'perceived potential competition' on routes in Renfrewshire and East Renfrewshire where they do not compete head-to-head. 'Perceived potential competition' was particularly strong between McGill's and Arriva since the costs of switching supply from one route or flow to another were comparatively low given their existing network strength in the area. This conclusion is supported by the evidence that the parties are each other's closest competitors as set out at paragraphs 42) and 44) above.
- 62) The OFT therefore considers that the merger gives rise to a realistic prospect of a substantial lessening of competition in the supply of commercial local bus services on the aggregated network level in the areas of Renfrewshire and East Renfrewshire. Specifically, this competition concern affects the non-overlapping flows on the routes operated by each of the parties in the Renfrewshire and East Renfrewshire area.

BARRIERS TO ENTRY AND EXPANSION

- 63) Where the combination of merging businesses raise potential concerns about the ability to raise prices or reduce quality or, in the case of transport mergers, reduce frequencies, the OFT also considers the responses of others. Entry by potential rivals, or expansion by existing rivals, can mitigate the effect of a merger on competition. In assessing whether entry or expansion might mitigate a finding of a substantial lessening of competition, the focus is on

whether such behaviour would be timely, likely and sufficient in scope.⁵⁷

64) In its report on the Stagecoach/Preston Bus merger, the CC noted in relation to competitive entry or expansion:

‘In order for it to be an effective constraint, it needs to have sufficient potential impact on the profitability of the merged entity that it would be willing to alter its actions, and not take advantage of any market power, so that it does not attract entry against it. It is doubtful whether very small scale entry, perhaps on just one route with a very small number of buses, would be sufficient to induce Stagecoach to change its pricing and service strategy for the whole (or a substantial part) of the Preston area. We consider that there would need to be a credible threat of repeated entry by several small players, or alternatively a larger-scale entry (or where entry is on a small scale, the entrant has an ability to expand easily) would be required to act as a constraint’.

65) The CC report identifies a number of barriers to entry and expansion into the supply of local bus services, including:

- cost of entry and expansion
- incumbent reactions to entry and expansion (including strategic retaliation in response to new entry or expansion)
- network and multi-journey ticketing effects and
- regulation.

Each of these issues is considered below.

Costs of entry and expansion

⁵⁷ OFT 1254, Merger Assessment Guidelines, section 5.8.

- 66) The parties submit that the bus industry is characterised by low barriers to entry and expansion, in particular in relation to investment, infrastructure, skill sets and access to capital. They point to the proliferation of competition in Glasgow and the surrounding areas and to McGill's own organic growth since 2008 as evidence of this.
- 67) The parties suggest that there are plenty of premises in the Glasgow area that could be used as a bus depot either by a new entrant or for expansion. The parties also note that space (for parking buses) may be rented in another company's yard as is common in the logistics sector while maintenance can be carried out at a commercial repairer, with more than 20 such companies in the area under consideration. Furthermore, the parties note that a significant amount of contracted work is available from the Strathclyde Partnership for Transport (SPT) on behalf of local authorities, which, the parties suggest, provides a means of entry.
- 68) In the local bus services report, the CC found that there are a number of barriers to entry and expansion which have the effect of reducing the strength of entry or potential competition as constraints on incumbents. These are:⁵⁸
- that a new bus service may take a considerable amount of time (up to several years) to achieve profitability, when launched in competition with an existing service, and⁵⁹
 - expected intensity of post-entry competition.
- 69) The findings of the CC report confirm that access to depots is not a general concern in the local bus services industry.⁶⁰

⁵⁸ CC, Local bus services report, paragraph 9.210 to 9.213.

⁵⁹ CC, Local bus services report, paragraph 9.16.

⁶⁰ CC, Local bus services report, paragraphs 9.162 to 9.173.

- 70) The OFT notes that in the area of Renfrewshire and East Renfrewshire, there are currently two large incumbents (the merging parties) as well as two smaller bus operators, each of whom indicated that [].
- 71) Neither did the larger bus operators active in the neighbouring area of Glasgow indicate that they would enter the market for the supply of local bus services in Renfrewshire and East Renfrewshire in the case of a small but significant increase in price (see above at paragraph 59) and 60).
- 72) No evidence has been received during the merger investigation to suggest that new entry or expansion is currently likely.

Incumbent reactions to entry and expansion (including strategic retaliation in response to new entry or expansion)

- 73) The OFT and CC Joint Merger Assessment Guidelines note that:

‘The Authorities will consider not only the scale of any barriers to entry and/or whether expansion may impact on the likelihood of entry or expansion but also whether firms have the ability and incentive to enter the market []. [E]ntrants may nevertheless be discouraged from entry by [] the credible threat of retaliation by incumbents’.⁶¹

- 74) The CC report notes that one motivation for an incumbent operator to engage in competitive behaviour that could be loss making is to engage in reputation building. An incumbent may wish to engage in aggressive conduct to establish a reputation for being strong and thus discourage further entry or expansion. The CC also notes that there may be benefits from preventing a rival from establishing itself in an area as the rival could then expand further from this base.⁶²

⁶¹ OFT 1254, Merger Assessment Guidelines, paragraph 5.8.8.

⁶² CC Local bus services report, paragraph 9.38(a).

- 75) Third party comments in the context of this transaction indicated that one reason why entry or expansion is unlikely, at this point, is that retaliation by the incumbent parties is a possibility. This is consistent with the CC finding that aggressive behaviour can create a lasting reputation for retaliation with smaller bus operators in particular.
- 76) The OFT therefore considers that there is scope for incumbent operators to react strategically to entry or expansion.

Network and multi-journey ticketing effects

- 77) Multi-journey ticketing schemes create incentives to use a particular network provider only. In terms of the implications of such network effects on barriers to entry and expansion, the CC report observed that new operators or operators with limited and relatively infrequent services face larger network and ticketing barriers relative to the larger incumbent operators.⁶³ In this case, both merging parties do offer multi-journey ticketing schemes, and to some extent the current transaction could be seen as increasing network effects, and thereby raising barrier to entry or expansion for smaller competitors in particular. In any event, the OFT's information suggests that entry by potential competitors who could offer multi-journey ticketing schemes in competition with the merging parties is unlikely to be timely and likely (see also above).

Regulation

- 78) The parties argue that, while the bus industry is a deregulated industry, there are regulatory constraints upon bus operators creating barriers to entry and expansion. The parties submit that the OFT should take into account a number of forthcoming regulatory

⁶³ CC Local bus services report, paragraph 9.217.

changes applicable to all Scottish bus operators in its assessment of barriers to entry and expansion:

- The introduction of Statutory Quality Partnership (SQP) schemes in Glasgow and Paisley to comply with the requirements for Euro 3 emissions.
- Cuts to the Scottish Bus Services Operators Grant (BSOG) subsidy regime from 1 April 2012 affecting all registered local bus services.
- Changes to the forthcoming Scottish concessionary travel scheme which will come into effect from 1 April 2013.
- The impending Disability Discrimination Act (DDA) regulations which will require investment in bus fleets.

79) McGill's also argues that the general economic downturn is reducing customer numbers and revenue growth, which means that operators face reduced margins. Overall, these changes, McGill's argues, will lead to:

- major funding reductions (BSOG and concessions), and
- the need to invest to meet the more stringent impending legislative requirements (SQPs and DDA).⁶⁴

80) In its report on local bus services, the CC notes that some bus operators are of the view that the overall burden of regulation in the industry is excessive and may impede operators' ability to operate bus services and deter entry. The CC concludes, however, that while attracting some compliance costs, regulation attached to local bus

⁶⁴ In discussing the need for initial undertakings, McGill's has commented that a significant proportion of the buses to be acquired from Arriva are considered not to be road-worthy. It has also made clear that bus upgrades are required to meet quality standards.

services does not tend to have a great impact on a new entrant or expanding operators compared with an existing operator and as such does not raise additional barriers to entry or expansion.⁶⁵

- 81) The OFT notes that only very limited concerns were raised by third parties in relation to the regulatory framework applicable to bus companies. One competitor noted that getting 'discs' from the Traffic Commissioner could take up to six months, while another observed that the proposed reductions in bus subsidies would make entry or expansion unlikely.
- 82) Overall, the OFT accepts that there are compliance costs associated with regulation. However, the OFT does not consider that these create barriers to entry or expansion.

Conclusions on barriers to entry and expansion

- 83) As set out above at paragraphs 74) to 76), the OFT considers that there is scope for the merged entity to create strategic barriers to entry with the intention to deter entry or expansion and that there is some evidence emerging from its market investigation in this case to suggest that incumbent retaliation is a credible threat. Furthermore, the OFT considers that, in addition to strategic barriers to entry, as explained above, barriers to entry and expansion are substantially higher for smaller bus operators, impacting on their ability to and incentive to enter into or expand into the market.
- 84) Larger bus operators noted that that they are unlikely to enter into the market for local commercial bus routes in Renfrewshire and East Renfrewshire, even if there is a small but significant increase in price. The OFT therefore concludes that entry and/or expansion by larger bus operators, with network scope to be able to rival the merged entity, cannot currently be considered to be sufficiently timely and likely to constrain the merged party.

⁶⁵ CC Local bus services report, paragraphs 9.189 and 9.195.

THIRD PARTY VIEWS

- 85) The OFT received a comparatively high number of responses during the course of its investigation, particularly from bus users in Inverclyde, Renfrewshire and East Renfrewshire. This includes comments from passengers, competitors, businesses and public authorities. The OFT also received some enquiries from Members of Parliament and Members of the Scottish Parliament, asking the OFT to investigate the merger.
- 86) Some respondents were very much in favour of the acquisition, noting that McGill's had done a lot to improve service standards in the bus industry locally. Others were concerned that the merger would lead McGill's to reduce service frequencies and raise fares. Of the customer responses:
- about two-thirds of customers expressed concerns about the merger arguing that fares might increase and service frequencies reduce, and
 - approximately one third of respondents were of the view that the quality of McGill's buses and their service levels were better than those of Arriva and that the merger should be allowed to proceed on these grounds.
- 87) One local authority argued that the merger should be cleared. A second local authority argued that competition had reduced the revenue return to both operators and that the merger would allow McGill's to earn higher margins, noting that McGill's had assured it that the merger would have no negative effect.
- 88) Competitor operators considered that they would be unlikely to enter the local bus market in Paisley, Renfrewshire and East Renfrewshire in competition with the merged entity in response to a small but significant increase in price or a small but significant decrease in service qualities. Some operators were concerned by the transaction, noting that it would remove any competition from McGill's.

ASSESSMENT

- 89) The OFT considers that the relevant product market in this case is the supply of commercial local bus services in the areas of Renfrewshire and East Renfrewshire.
- 90) The current transaction involves a reduction in actual competition (overlap on certain flows) as well as the removal of a constraint from potential competition. In terms of actual overlap flows, the merger results in a merger to monopoly in terms of effective competitors on seven flows. On a further three overlap flows, the merger reduces the number of effective competitor operators from three to two.
- 91) The OFT's investigation indicated that, in terms of their network and their overlapping services, McGill's and Arriva should be seen as close competitors. Third parties were concerned about the loss of competition between the parties. The OFT has not seen evidence to indicate that there is a sufficient constraint from the threat of expansion by other operators on these flows to prevent competition concerns from arising, nor that actual entry or expansion is likely. On this basis, the OFT considers 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 on these 10 overlap flows.
- 92) Having examined the route networks of the parties in the Renfrewshire and East Renfrewshire area, the OFT also believes that the merger removes each party's key potential competitor at the level of the bus network in this area. Even if the parties were not actually competing on the same routes or flows, the OFT considers, given their network presence, that they are likely nonetheless to exert significant competitive constraints on each other through perceived potential competition. The OFT therefore considers that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition in the supply of commercial local bus services on the aggregated network level in the areas of Renfrewshire and East Renfrewshire.

EXCEPTIONS TO THE DUTY TO REFER

De Minimis

- 93) The parties submit that, were the OFT to find itself under a duty to refer, it should exercise its discretion to apply the markets of insufficient importance (or 'de minimis' exception). In line with the OFT's published guidance, the OFT considers whether the 'de minimis' exception should be applied where the aggregated annual value in the UK of the market(s) affected by the merger is no more than £10 million.⁶⁶
- 94) The OFT estimates that the total revenues earned on the 13 overlap flows were valued at £[] million. It further considered that revenues from three flows, where the revenue on the overlap flow was less than 10 per cent of the revenues earned from corresponding routes, should be deducted from the value of £[] million.
- 95) The OFT identified a realistic prospect of a substantial lessening of competition in relation to:
- the supply of commercial local bus services on a disaggregate flow-by-flow level in relation to:
 - seven flows for which the merger represents a reduction in the number of effective competitors from two to one, and
 - three flows for which the transaction reduces the number of effective competitors from three to two, and
 - the supply of commercial local bus services on an aggregate (network) level through the removal of potential competition in the area of Renfrewshire and East Renfrewshire.

⁶⁶ OFT Mergers – Exceptions to the duty to refer and undertakings in lieu of reference guidance (OFT1122), paragraph 2.14.

- 96) The OFT understands that the value of the overlap flows is in aggregate likely to be between £[] million and £[] million.ⁱⁱⁱ This figure is [in excess of] the £3 million figure, below which the OFT states in its guidance that it would expect to refer a merger only exceptionally.⁶⁷ The OFT is mindful that the majority of overlap flows accounting for this revenue are ones where the merger leads to a merger to monopoly in the number of effective competitors on the route. On this basis, the OFT would not be minded to apply the 'de minimis' exception even having regard only to the flows on which the test for reference was met in relation to a loss of actual competition.
- 97) However, the OFT does not believe that the affected market in this case should be limited to the value of revenues on the overlap flows. As explained at paragraphs 54) to 62) above, the OFT believes that it is or may be the case that the merger in the Renfrewshire and East Renfrewshire area has resulted or may be expected to result in a substantial lessening of competition as a result of a loss of perceived potential competition.
- 98) On this basis, the OFT believes that the affected market should be considered to extend to all routes in Renfrewshire and East Renfrewshire, which collectively have a value in excess of £10 million (the OFT estimates that the value of McGill's network in this area would be around £[] million and Arriva's £[]million).
- 99) Therefore, given that the size of the affected market in this case is materially greater than £10 million, consistent with its guidance, the OFT considers the present case is not a candidate for the exercise of the 'de minimis' exception.

Customer benefits exception

- 100) Under section 22(2)(b) of the Act, the OFT may decide not to make a reference where it believes that any relevant customer benefits in

⁶⁷ Ibid, paragraph 2.15.

relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition concerned.

101) Section 30 of the Act defines such benefits as including, lower prices, higher quality, greater choice or greater innovation. For the OFT to exercise its discretion not to refer a merger on this basis, the claimed customer benefits must be clear, and the evidence in support of them must be compelling.⁶⁸

102) The parties did not submit that the merger has given rise to customer benefits. However, the OFT was mindful that, as part of the market test, it did receive some evidence from customers suggesting that the quality of McGill's buses and overall service levels is better than Arriva's (see paragraph 86) above). The OFT also notes that the merger will make multi-journey tickets available across a larger network, hence benefiting consumers. It is unclear, however, whether such benefits could not also be achieved by other means in the absence of the merger.

103) The OFT did not have access to sufficient information to allow it to conclude with any certainty that such customer benefits outweigh the potential consumer detriment flowing from the merger. On the contrary, the OFT also received complaints suggesting that consumers are concerned about increases in fares and a reduction in bus frequencies (see paragraph 86) above).

104) As such, while the OFT considers it plausible that the merger might indeed lead to some limited customer benefits, it has been provided with insufficient evidence that these benefits are clear, timely and merger-specific and that they would outweigh the adverse effects anticipated as a result of the substantial lessening of competition caused by the merger.

⁶⁸ OFT 1122, paragraph 4.9.

UNDERTAKINGS IN LIEU OF REFERENCE

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

106) In considering such undertakings in lieu of reference, the OFT's published guidance makes clear the requirement that:

'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... Undertakings in lieu of reference are therefore appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut.'⁶⁹

107) The parties made a number of offers of undertakings in lieu of a reference to the OFT to address the local unilateral effect concerns. The remedies, as offered by the parties, included caps on fares (in line with cost increases) and caps on frequency reductions, in relation to a number of routes, potentially extending to all routes in McGill's current Renfrewshire network. In addition, McGill's offered to participate in a Multi Operator Ticketing Scheme, as envisaged and developed by SPT. McGill's stated as part of its offer that the SPT had stated its willingness to be involved in the monitoring of McGill's compliance with such undertakings.

108) The OFT's policy position, as set out in its guidance and discussed at paragraph 106) above, is that undertakings in lieu should act in a

⁶⁹ OFT 1122, *Mergers – Exceptions the duty to refer and undertakings in lieu of reference guidance*, paragraphs 5.6 and 5.7.

clear-cut fashion. The proposed remedies are of a behavioural nature, and the OFT is generally unlikely to consider that behavioural undertakings will be sufficiently clear cut to address the identified competition concerns.⁷⁰ In this case, having examined the undertakings in lieu offer carefully, the OFT does not consider such remedies to be clear-cut and considers that the risks associated with behavioural undertakings as identified in the OFT's guidance would be present in this case.⁷¹ Although the OFT notes the offer of involvement by SPT in the monitoring of the undertakings, it is not clear how this would function in practice, nor is it clear that this involvement would alleviate the risks that behavioural undertakings bring in terms of effectiveness.

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

DECISION

110) The completed transaction will be referred to the Competition Commission pursuant to section 22(1) of the Act.

ⁱ McGill's disputes that the overlaps in the parties' network of routes extends to a significant part of East Renfrewshire.

ⁱⁱ The parties dispute that they are the two largest operators of bus routes in East Renfrewshire.

ⁱⁱⁱ The parties contest this aggregate number and estimate it to be lower.

⁷⁰ Ibid, paragraph 5.39.

⁷¹ Ibid, paragraphs 5.40 and 5.41.