OFFICE OF FAIR TRADING

Completed acquisition by Stena AB of certain vessels and assets from DFDS A/S operated on the Irish Sea

ME/4790/10

The OFT's decision on reference under section 22(1) given on 8 February 2011. Full text of decision published 25 March 2011.

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. Stena AB (**Stena**)[1] owns and operates passenger and freight ferry services between the island of Ireland and Great Britain (GB).[2] It also owns two ports in Great Britain (Holyhead and Stranraer), has a 50 per cent share in two other ports—Fishguard (GB) and Rosslare (Republic of Ireland)—and is building a new port at Loch Ryan in south west Scotland. Stena is ultimately controlled by Sten A. Olsson who also controls businesses in shipping (including bulk shipping, oil tankers and ship management), offshore drilling, property, financial activities, recycling, environmental services and trading. These activities achieved a worldwide turnover in 2009 of approximately £3.9 billion, of which approximately £[ ] million was achieved in the UK.

2. **The Target**[3] owns and operates the passenger and freight ferry business on the Irish Sea of the former DFDS Liverpool-Belfast and Heysham-Belfast routes.[4] Its turnover in 2009 was £[ ] million.

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[1] Via some of its subsidiaries. This transaction [ ] involves Stena Line (UK) Limited.

[2] Stena's routes in the Irish Sea include Stranraer-Belfast, Holyhead-Dublin, Holyhead-Dun Laoghaire and Fishguard-Rosslare. Stena ceased operating sailings on the Fleetwood-Larne route on 24 December 2010.

[3] Grouped under the corporate structure of DFDS Seaways Irish Sea Ferries Ltd. Until selling the Target and exiting the remaining services from the Irish Sea at the end of January 2011, DFDS used

TRANSACTION

3. Stena completed the acquisition of the Target on 1 December 2010. The statutory deadline for the OFT to decide on whether this transaction should be referred to the Competition Commission expires on 31 March 2011. The submission was deemed satisfactory on 6 December 2010 and the OFT's administrative deadline expires on 8 February 2011.

4. The sale and purchase agreement (SPA) between the parties did not include two routes that DFDS retained in the Irish Sea: Liverpool-Dublin and Heysham-Dublin[5]. At the same time as entering into this SPA, Stena and DFDS also [ ].[6]

JURISDICTION

5. Prior to the merger, each party formed an enterprise.[7] These enterprises have now ceased to be distinct.

6. The Target's UK turnover in 2009 was £[ ] million, so the turnover test is not met. Stena and the Target (the merged parties) overlapped in the supply of ferry services in the Irish Sea. Their combined share of supply in the provision of freight ferry services between Great Britain and the island of Ireland is [35-45] per cent (with an increment of [10-20] per cent), above the threshold of the share of supply test pursuant to section 23 of the Act.

7. As a result, the OFT believes that it is or may be the case that this acquisition gives rise to a relevant merger situation since two or more enterprises appear to have ceased to be distinct and the share of supply test appears to be met.

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to operate four freight and passenger routes. These are Heysham-Belfast, Heysham-Dublin, Liverpool-Belfast, and Liverpool-Dublin.

[4] DFDS agreed to acquire the Norfolkline ferry business which included the Irish Sea routes relevant to this transaction, from AP Møller-Mærsk A/S on 17 December 2009 and obtained competition clearance from the European Commission on 17 June 2010.

[5] On 13 January 2011, DFDS announced that these routes will cease trading from 31 January 2011.

[6] [ ]

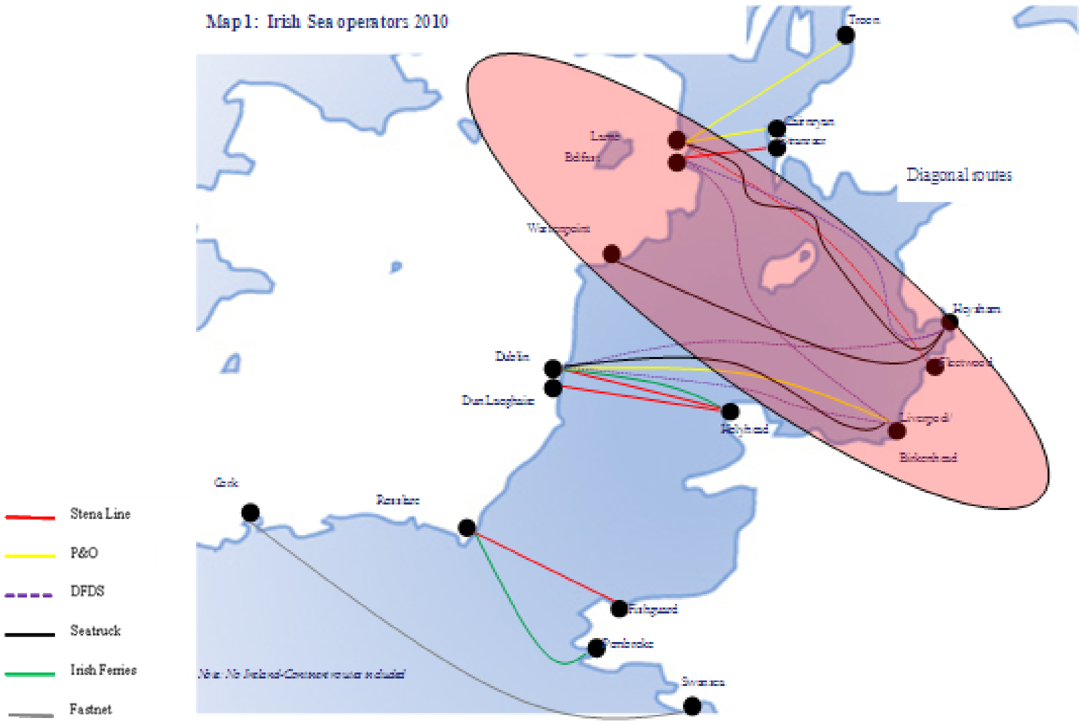
[7] As noted in paragraph 3.2.3 of the Merger Assessment Guidelines, '[i]n making the judgement as to whether or not the activities of a business, or part of a business, constitute an enterprise under the Act, the Authorities will have regard to the substance of the arrangement under consideration, rather than merely its legal form'. It adds that '[i]n some cases, the transfer of physical assets alone may be sufficient to constitute an enterprise, for example where the facilities or site transferred enable a particular business activity to be continued.'

RELEVANT FRAME OF REFERENCE

Introduction

8. The transaction concerns ferry transport services for freight and passengers between Great Britain and Northern Ireland. Ferry operators can often carry both freight and passengers on the same vessels. Ferry operators offer freight services for unitised freight, that is freight which for the purpose of transport is stored in various standardised forms (such as driver-accompanied vehicles, unaccompanied vehicles and containers). Unitised freight can be carried on roll-on/roll-off (ro-ro)[8] or lift-on/lift off (lo-lo)[9] vessels.

9. The following map shows ferry services across the Irish Sea in 2010 prior to the merger, prior to the closure of Stena's Fleetwood-Larne route on 24 December 2010 and prior to the announced closure of DFDS's Heysham-Dublin and Liverpool-Dublin routes in January 2011. The shaded area shows the routes most relevant to the merger—those between north-west England and Northern Ireland, in what it known as the 'diagonal corridor'.



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[8] Roll-on/roll-off (ro-ro) relates to the transport of unitised freight where freight is driven on and off the vessel, usually on a lorry trailer.
[9] Lift-on/lift off (lo-lo) relates to the transport of unitised freight by lifting the container on/off the vessel by using special container port cranes.

Product scope

Freight services

10. In 2004, the OFT and the Competition Commission (CC)[10] concluded that freight and passenger ferry services in the Irish Sea constituted separate markets because of their different demand characteristics. The 2004 OFT decision and CC report also concluded that ro-ro and lo-lo were part of the same market.

11. The OFT has seen no evidence to warrant departing from these market definitions. However, responses from several third parties in this case have suggested a potential further segmentation between accompanied and unaccompanied freight traffic. This is considered below.

<u>Accompanied and unaccompanied freight traffic</u>

12. The CC Irish Sea report treated accompanied and unaccompanied freight as a single market, but noted the different nature of accompanied and unaccompanied operations, and that there might be some differences in the reaction of ferry operators and their customers in each of these segments to market events.[11]

13. Stena contends that both accompanied and unaccompanied traffic should be treated as part of the same market for reasons of both supply- and demand-side substitutability, and that any different approach would be contrary to the CC Irish Sea report and numerous EC precedents.[12]

14. The information available to the OFT on this point is mixed. On the one hand, the OFT has received representations from customers and a competitor which have stressed the distinction between accompanied and unaccompanied freight. Accompanied traffic tends to be more expensive,

[10] OFT decision of 27 August 2003 on the proposed acquisition by Stena AB of several vessels and routes in the Irish Sea from the Peninsular and Oriental Steam Navigation Company (the OFT Irish Sea decision); A report on the proposed acquisition by Stena AB of certain assets relating to the supply of ferry services on the Irish Sea between Liverpool-Dublin and Fleetwood-Larne, February 2004 (the CC Irish Sea report).
[11] Accompanied freight refers to loads which are 'accompanied' by a driver during the ferry crossing. Unaccompanied freights are unhitched during the crossing and collected by a different traction head on arrival.
[12] Stena's Response to the OFT's Issues Paper, paragraphs 4.3 and 4.6. See also for example, Case No COMP/M.5756 DFDS/Norfolk, decision of 17 June 2010, paragraph 11.

they said, and serves companies willing to pay the extra cost to have their cargo with a driver at all times. There are also different levels of capacity for accompanied and unaccompanied traffic on different Irish Sea routes, in particular on Seatruck's routes from Heysham which focus on unaccompanied traffic given the limited cabin facilities of its vessels. These factors might suggest that customer switching from one form of traffic to the other in response to a 5 per cent price increase is likely to be limited. If so, then such a price increase may be profitable, in which case accompanied and unaccompanied traffic would constitute separate markets.

15. On the other hand, several customers told the OFT that, as a result of the closure of Stena's Fleetwood-Larne route, they might be considering switching from accompanied to unaccompanied traffic, as there is more ferry capacity for the latter. The evidence available for the two weeks following the closure of this route (at the start of 2011) did not show any such switching. However, the OFT considers that data for such a short period might not give a reliable estimate of the degree of switching, not least because the flow of traffic at that time of year can be irregular. As such, the OFT also took a cautious approach in interpreting this information.

16. The outcome of the OFT's assessment of the merger does not depend on this distinction, however, and consequently, the OFT has not concluded on whether accompanied and unaccompanied freight constitute separate relevant product markets. Nonetheless, this distinction is taken into account in the OFT's competitive assessment of the merger.

Passenger services

17. The CC Irish Sea report did not consider candidate product markets for passengers that were wider than ferry services across the Irish Sea.

18. Stena submits that 'low cost' airlines represent a significant constraint on passenger ferries services between Great Britain, Northern Ireland and the Republic of Ireland. Stena also submits that passenger ferry services are a very small proportion of the business affected by this merger. For example passengers accounted for less than [ ] per cent of the revenue on Stena's Fleetwood-Larne route.

19. Another ferry operator agrees with Stena's statement that 'low cost' airlines constrain passenger ferry services but other third parties' views were mixed in this regard. Further, it is not clear that—just because passengers do not account for much revenue—this would prevent a price rise targeted at passengers in the event of enhanced market power.

20. On a cautious basis, therefore, the OFT has assessed the impact of this transaction separately on the supply of passenger ferry services.

Geographic market

Freight services

21. In its 2004 Irish Sea report, the CC noted evidence suggesting that the location of ports, relative to the origin and destination of the goods and any depots, was the key factor affecting customers' choice of routes. However, other important factors included the availability of timely crossings, the reliability of the crossings, road and ferry costs, the operational relationship between the customer and the ferry company, and drivers' facilities. The CC considered that these other factors suggested at least some willingness to substitute between ports by customers.[13]

22. The CC noted that the closest alternatives from a geographic viewpoint to the Fleetwood-Larne route (a target route in that case) were the other routes in the diagonal corridor between north-west England and Northern Ireland, including: Liverpool-Belfast, Heysham-Belfast (the acquired routes in this case) and Heysham-Warrenpoint (operated by Seatruck). The CC interpreted its survey results as suggesting that 'the shorter Loch Ryan crossings to Northern Ireland were regarded as substitutes for diagonal crossings terminating in Northern Ireland; and certainly were better demand-side alternatives to [the] Fleetwood-Larne route than were the central or southern routes.' The CC considered that the geographic market in which Fleetwood-Larne competed was the 'northern corridor', including both the diagonal and the Loch Ryan crossings, but that it did not extend to either the central corridor (routes to and from the Dublin area) or the southern corridor (between South Wales and the southern part of the Republic of Ireland).

[13] CC Irish Sea report, paragraph 4.22.

23. Stena submits that for accompanied and unaccompanied freight, the diagonal routes should be considered as the relevant geographic market for the purposes of the transaction: that is, Fleetwood-Larne (Stena)[14], Liverpool-Belfast, Heysham-Belfast (both DFDS), Heysham-Warrenpoint and Heysham-Larne (both Seatruck). It contends that 'the competitive constraints on ferry services on the Irish Sea are provided by close competitors and not by routes located several hours drive away, and which offer customers entirely different profiles in terms of overall journey costs, times and frequencies of services.'[15] In its view, neither the Loch Ryan routes nor the central corridor routes exert a significant competitive constraint on the diagonal routes. In support of these arguments, Stena has submitted: i) summaries of interviews with customers; ii) its estimates of anticipated likely switching behaviour following the closure of Fleetwood-Larne; iii) data on actual switching following the closure of Fleetwood-Larne on 24 December[16]; and iv) data on average journey times and average total costs, which is presented below:

Average Journey Time				
	Manchester/Belfast		**London/Belfast**	
	Accompanied	Unaccompanied	Accompanied	Unaccompanied
Loch Ryan corridor	0 hours 27 minutes	2 hours 12 minutes	5 hours 27 minutes	7 hours 12 minutes
Diagonal corridor	1 hours 36 minutes	3 hours 21 minutes	6 hours 32 minutes	8 hours 17 minutes
Long sea central corridor	3 hours 12 minutes	4 hours 57 minutes	7 hours 57 minutes	9 hours 42 minutes
Short sea central corridor	0 hours 39 minutes	2 hours 24 minutes	5 hours 12 minutes	6 hours 57 minutes

[14] As explained further in paragraph 38 below, Stena submits that the Fleetwood-Larne route should not be included in this assessment because it was going to be closed regardless of this merger. However, it is included in this analysis of the candidate geographic market because geographically it would be within the scope of the 'diagonal routes'.
[15] Response to the Issues Paper, paragraph 4.2.
[16] Response to the Issues paper, paragraph 4.12.

Average Total Cost				
	Manchester/Belfast		London/Belfast	
	Accompanied	Unaccompanied	Accompanied	Unaccompanied
Loch Ryan corridor	£714.6	£581.5	£1,041.0	£907.9
Diagonal corridor	£443.5	£315.6	£765.9	£638.0
Long sea central corridor	£582.8	£450.6	£894.3	£762.1
Short sea central corridor	£809.5	£597.2	£1,104.5	£892.2

24. Some of this evidence mentioned in paragraph 23 is likely to reflect prices and available capacity prior to the closure of the Fleetwood-Larne route whereas some may reflect the effect of the closure of the route and DFDS's announced closure of Heysham-Dublin and Liverpool-Dublin. In this regard, some third parties told the OFT that changes to the market resulting from Stena's closure of Fleetwood-Larne and DFDS's announced closure of Heysham-Dublin and Liverpool-Dublin might take some time to settle and it was too early to anticipate whether the borders of the traditional corridors[17] of the Irish Sea would remain the same.

25. That said, Stena believes that adopting a wider 'northern corridor' market definition would be incorrect because it: i) would be based on the 2004 CC findings which were immaterial to the outcome of that case, and the CC described the survey evidence supporting such a market definition as unreliable; ii) is contradicted by third parties' responses in this case; iii) is contradicted by Stena's evidence on customer behaviour and route profiles; and iv) 'appears utterly unlikely on a basic common sense consideration of the relative similarities' between the DFDS Liverpool-Belfast route and, on the one hand, Troon-Larne (which is included in this market definition) and, on the other hand, Liverpool-Dublin (which is not).[18]

26. Third parties' responses (prior to and following the merger) to the OFT's enquiries were mixed. Each customer has its own requirements and alternative substitution options. Broadly speaking, users of particular routes had a marked preference for using a similar origin/destination pair where possible. Following the merger, some customers have noticed the reduction

[17] These being the northern, short sea Scotland, short sea central, diagonal, middle and southern corridors.
[18] Response to the Issues Paper, paragraph 4.3.

in capacity on the diagonal routes and have told the OFT that this has led them to move their freight to other routes in the Irish Sea. However, and consistent with Stena's view rejecting a wider geographic market, the balance of evidence from Stena and third parties on the extent of this diversion indicated that the hypothetical monopolist test is likely to be satisfied for the freight ferry routes in the diagonal corridor and that this may be the narrowest market that satisfies the hypothetical monopolist test.

27. On this basis, the competition analysis of freight services below is carried out using the market for diagonal freight ferry routes as a framework. However, the OFT notes that market definition is a binary test whereas there tends to be a spectrum of different competitive constraints. The adoption of the diagonal freight routes as the narrowest possible market does not necessarily imply that there are no constraints from outside that market which should be taken into account in a full competitive assessment. We also, therefore, briefly consider below the implications of the merger on a wider geographic market for freight, albeit that this discussion is not determinative for the decision.

Passenger services

28. Stena submits that for passenger services the relevant geographic market consists of the long Irish Sea routes from northern England only (i.e. the diagonal routes plus Liverpool-Dublin), with a lesser competitive constraint provided by the short sea central corridor[19] and the Scotland–Northern Ireland crossings. As discussed above, Stena submits that low cost airlines provide an additional competitive constraint on passenger ferry services, widening the geographic market further.

29. The CC did not address the geographic scope of Irish Sea passenger markets in its report. The OFT notes that the DFDS website marketed its Belfast-Liverpool route as an alternative to Northern Ireland-Scotland crossings, offering a shorter driving distance for destinations in England.[20] This may provide some basis for a 'northern corridor' frame of reference for passenger services (as defined in the CC Irish Sea report).

[19] 'The short sea corridor' has traditionally been defined as including the following services: Holyhead-Dublin and Holyhead-Dun Laoghaire.
[20] 'The Liverpool service provides overall cost savings with a direct link to the heart of England compared to the longer drive alternative through Scottish ports.' (see http://www.norfolkline.com/EN/Irish_Sea_Ferries/Belfast_Liverpool/).

30. Stena challenged the use of this marketing material for the purpose of market definition. Moreover, Stena contends that in the event that customers diverted away from the diagonal corridor routes, they would more likely to choose (i) to fly, (ii) to use the long sea P&O Liverpool-Dublin service, or as a last resort (iii) to use the short sea routes that P&O and Irish Ferries operate.

31. Overall, given that the short sea crossings to Scotland are much more heavily patronised by passengers than the diagonal routes, it seems plausible to the OFT that the short sea routes exert some competitive constraint on the diagonal routes, even if the converse is not true. However, the OFT has not needed to reach a conclusion on the precise market definition for the supply of passenger ferry services. Taking a cautious approach, it has assessed the impact of this transaction on the basis of the supply of ferry passenger services in the northern corridor (as defined by the CC Irish Sea report).

SUBSTANTIVE ANALYSIS

32. As stated in the Merger Assessment Guidelines[21], 'the application of the [substantial lessening of competition] test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the ‘counterfactual’'.

The counterfactual

Introduction

33. The OFT will generally adopt the prevailing conditions of competition (or the pre-merger situation in the case of completed mergers) as the counterfactual against which to assess the impact of the merger.[22] However, the OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, the OFT considers that the prospect of prevailing conditions continuing is not realistic (for example because the OFT believes that one of the merger firms would inevitable have exited from the market).

[21] Merger Assessment Guidelines, paragraph 4.3.1.
[22] Merger Assessment Guidelines, paragraph 4.3.5.

34. In the current case, a key issue is whether the appropriate counterfactual for assessing the impact of the merger should incorporate the closure of Stena's Fleetwood-Larne route. While this closure was announced on 2 December 2010 and the merger completed on 1 December 2010, Stena argues that the decision to exit this route was not influenced by its decision to acquire the Target routes.

35. As stated in the Merger Assessment Guidelines[23] in forming a view on an exiting firm scenario, the OFT will consider:

    35.1. whether the firm would have exited (through failure or otherwise[24]); and if so

    35.2. whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration; and

    35.3. what would have happened to the sales of the firm in the event of exit.

36. The Merger Assessment Guidelines state that '[f]or the OFT to accept an exiting firm argument, it would need (on the basis of compelling evidence) to believe that it was inevitable that the firm would exit the market'.[25] In this case, the OFT has assessed carefully both the sequence of events leading up to the closure of the Fleetwood-Larne route and the decision to acquire the Target routes to determine whether there was any causal link between the two. This is because for the OFT to accept that Stena's exit from Fleetwood-Larne was inevitable, the OFT must believe on the basis of compelling evidence that the decision to exit the route was not influenced by the decision to acquire the Target routes.

37. As a first phase agency, the OFT must adopt a cautious approach when assessing a merger involving the exit of a merging party absent the transaction (the 'exiting firm scenario'). In doing so, and as noted above, there must be compelling evidence which justifies a departure from a counterfactual based on pre-merger prevailing conditions of competition[26]. In the light of this, the application of these principles to the facts and evidence of this case is discussed below.

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[23] Merger Assessment Guidelines, paragraph 4.3.8.

[24] The Merger Assessment Guidelines recognise that 'exit may also be for' [reasons other than a 'failing firm'], 'for example because the selling firm's corporate strategy has changed' (paragraph 4.3.9).

[25] Merger Assessment Guidelines, paragraph 4.3.10.

[26] See also *Anticipated acquisition by Tesco Stores Limited of the five former Kwik Save stores (Handforth, Coventry, Liverpool, Barrow-in-Furness and Nelson)*, OFT decision of 11 December 2007, (*Tesco/Kwik Save*), paragraphs 8 and *ff*.

Application of these principles to this case

Whether the firm would have exited absent the merger

38. In this case, Stena submits that the relevant counterfactual incorporates its exit from the Fleetwood-Larne ferry service. Its closure was announced on 2 December 2010, the day after the merger completed, and the route closed on 24 December 2010. Stena submits that there is strong contemporaneous evidence showing that the route would have closed regardless of the merger and no evidence pointing to the contrary. In particular, Stena submits that:
    - 38.1. the route was heavily loss making for the first six months of 2010 and projections for the route showed no foreseeable prospect of profitable operation given current operating losses and the capital expenditure needed to replace the vessels on the route;
    - 38.2. it gave notice of termination to Associated British Ports (ABP) of the Fleetwood port contract on 9 June 2010 with effect from the end of December 2010 and without port access, Stena would be in no position to operate the route;
    - 38.3. the most senior board in the Stena Line group (the board of Stena Line Holding BV) had decided to close the route in September 2009, had required a closure plan and had reaffirmed its closure decision in March, April and June 2010;
    - 38.4. Stena's September 2009 closure decision was taken prior to any merger negotiations, not least because DFDS had not yet acquired Norfolkline (former owner of the Target's routes) by that time, with regulatory clearance being obtained in June 2010;[27]
    - 38.5. the three vessels operating on the route were near the end of their useful lives, resulting in reliability issues and problems with customers;
    - 38.6. the cost of new bespoke vessels suitable for the shallow water conditions at Fleetwood port was prohibitive and the vessels would be tied to operating at Fleetwood port;
    - 38.7. Seatruck was expanding its operations, notably from Heysham-Larne, putting Stena at a competitive disadvantage given the unreliable tidal conditions at Fleetwood; and
    - 38.8. two senior Stena managers gave witness statements to the OFT confirming that during 2010 they were working to no plan other than to shut the route.

[27] DFDS entered into an agreement to acquire Norfolkline on 17 December 2009 and obtained competition clearance from the European Commission for that transaction on 17 June 2010.

39. On this basis, Stena says that:

39.1. there is a clear narrative about closure through Stena's board presentations and resolutions going back to 2009;

39.2. the economic evidence shows that the route was loss-making with no chance of improvement primarily because of the need for investment in new vessels; and

39.3. there is corroborative evidence in the form of steps taken towards the route closure.

40. These three points are discussed below.

A clear narrative about closure

41. Stena submits that its narrative emerges from the witness statements supplied to the OFT by two members of its senior UK management [28] and from the documentary evidence that it provided to the OFT.

42. Stena told the OFT that it should attach particular weight to the witness statements on the basis of the judgment of the Competition Appeal Tribunal (CAT) in Stagecoach –v- Competition Commission[29] where the CAT found that the CC unlawfully rejected the evidence of a Stagecoach company director without proper cause. (That is, when the CC did not have a firm basis for rejecting it in the form of contemporaneous documents or other conflicting witness evidence, or because the evidence was itself inconsistent, inherently implausible or inexplicable for some other reason.)

43. The OFT considers that the significance of the CAT judgment to the present case is limited because it does not give directions in terms of how factually conflicting evidence should be handled, which is the issue that the OFT faces in this case, and because it was made in the context of a second phase inquiry, where the CC faces a stricter legal test than the OFT, has information-gathering powers that the OFT does not and has a longer investigation period than the OFT. Nevertheless, the OFT notes that Section 117 of the Act states that a person commits an offence (punishable by a fine and/or up to two years imprisonment) if s/he supplies, knowingly or

[28] [ ] dated 9 December 2010 and [ ] dated 7 December 2010.

[29] Stagecoach Group plc –v- Competition Commission, case number 1145/4/8/09, 21 May 2010, paragraph 111 (see http://www.catribunal.org.uk/files/1145_Stagecoach_Judgment_210510.pdf).

recklessly, any information to the OFT in connection with any of its functions that is false or misleading in a material respect. This applies regardless of whether that evidence is described by that person as a witness statement or not.

44. In the current case, both witness statements explain the process leading to the closure of Stena's Fleetwood-Larne route, the financial situation behind the closure, the timing of the decision on whether to invest in new vessels[30], the internal board meetings when the closure of the route was discussed, the review of alternatives to the closure, the timing of 'Project Stream' (the code name for the merger) and [ ]'s understanding that there was no alternative but to close the route regardless of the merger.[31]

45. In addition, Stena provided documentary evidence including board minutes and presentations referring to the closure of the Fleetwood-Larne route, the financial performance of routes in the Irish Sea[32] and the merger.

46. Stena submits that, taken together, this evidence indicates that it decided to close the Fleetwood-Larne route on 22 September 2009 prior to discussions leading to the current transaction; that a closure plan was developed after that date; that—while developing that closure plan—some options for relocating the Fleetwood-Larne route elsewhere were considered in order that Stena could continue operating in the diagonal corridor but that these were dismissed; and, that steps were taken during the development of the closure plan to proceed with the final closure of the route.

OFT assessment of the narrative about closure

47. In contrast to the above, however, other evidence available to the OFT does not suggest that Stena's decision to close Fleetwood-Larne in September 2009 was distinct from and uninfluenced by its decision to acquire the Target routes, or that it was irreversible.

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[30] '[I]n 2009, before the decision to close the route was taken, Stena considered the cost of investing in replacement vessels'. [ ]'s witness statement, paragraph 6. Also mentioned in [ ]'s witness statement, paragraph 7.

[31] [ ]'s witness statement, paragraph 16. In particular, [ ] says that 'the decision in relation to Fleetwood-Larne was a decision that was based on the financial situation of the route' and 'any attempt to continue the route was out of the question.'

[32] Stena has presented its financial analysis for Holyhead-Dun Laoghaire, Holyhead-Dublin, Fishguard-Rosslare and Stranraer-Belfast.

48. In this regard, the OFT makes the following observations. Firstly, although the closure of the Fleetwood-Larne route 'was first contemplated in 2009', Stena had by that time [ ][33,] ([ ])) to purchase one of the Target routes ([ ]) in the Irish Sea[34] and [ ].

49. Secondly, in spite of sustaining financial loses from 2008/09, and in spite of the decision to close the route in September 2009, it is unclear whether the decision that was made was irreversible. The decision in September 2009 was followed by further discussions about alternative options to closure and it took fifteen months to close the route, with closure eventually being contemporaneous with the acquisition.

50. These points are examined in more detail below.

Sequence of events

51. The first formal meeting between Stena Line and DFDS to discuss the acquisition occurred on 25 March 2010[35]. The merger agreement was finally signed on 1 December 2010. By contrast the decision of the Stena Board to close the Fleetwood-Larne route was minuted at the Board meeting of Stena Line Holding BV on 22 September 2009[36]. On this basis, Stena contends that the closure decision was taken: i) fifteen months before it acquired the Target; ii) prior to DFDS owning the Target[37]; and, iii) without any certainty that Stena would be able to acquire the Target. On this basis, Stena disassociates the merger and its decision to close the Fleetwood-Larne service.

52. However, as of September 2009, Stena was already attempting to acquire [ ] one of the Target routes and [ ].

53. Further, the OFT believes that these may well have influenced Stena's September 2009 closure decision (which was then revisited and 're-

[33] [ ]..
[34] [ ].
[35] This is also referred to in the witness statements. [ ]'s witness statement, paragraph 13 and [ ]'s witness statement, paragraph 11. See also Stena's response to the OFT additional information request received dated 8 December 2008 (received by the OFT on 15 December 2010), reply to question 14, schedule 3.
[36] '[ ]' (*An extract of the minutes from the meeting* as included in Schedule 22 of the Submission).
[37] See footnote 4 above.

confirmed' [subsequently[38] [39]])[40]. It seems likely that Stena would have had at least some expectation of acquiring these routes at this time. The OFT notes that the extracts of the Board minutes presented by Stena to the OFT include only elements that support the key strands of Stena's narrative, but it has not had access to a wider set of Stena, DFDS or [ ], briefings or presentations, prior to September 2009 or since, which might have helped in the consideration of these issues.

54. In addition, it seems that the first brief inquiry on the issue of Stena purchasing these routes from DFDS took place on 19 January 2010[41], during a brief meeting between Mr Dan Sten Olsson (Stena's majority shareholder) and Mr Niels Smedegaard (President and CEO of DFDS A/B). DFDS told the OFT that, [ ] and, therefore, that DFDS [ ]. The witness statements do not refer to this conversation. In response to questions about this meeting, Stena confirmed that it had enquired about DFDS's plans for its recently acquired Norfolkline business in the Irish Sea, but restated that no conversation about the merger took place before March 2010.

55. This sequence of events raises questions as to when Stena and DFDS commenced their merger deliberations and therefore how this timetable fits with key decisions taken to first agree and then confirm the closing of the Fleetwood-Larne route and exit the diagonal corridor. They key decisions appear to have occurred in September 2009, and then in March, April and June 2010.[42]

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[38] '[ ]' (Minutes of a meeting of the Board of Directors of Stena Line (Irish Sea) Limited held on 24 March 2010).
[39] See Schedule 23 of the Submission 'An extract of the minutes from the meeting'. In item 10 of the board minutes (Irish Sea development) '[ ]'. In item 11 of the board minutes (Project Stream), '[ ]' The material submitted to the OFT includes only: '[ ]'.
[40] Schedule 24 of the Submission 'An extract of the minutes of the meeting', in item 8 'Fleetwood-Larne update' '[ ]' Item 9 (Project Stream) '[ ].'
[41] At this meeting (and following the announcement of the DFDS acquisition of Norfolkline) [ ].
[42] See footnotes 38, 39 and 40 above. However, the OFT notes that DFDS public announcement of its 'strategic acquisition' states that 'a particular short term focus area is to facilitate a turnaround of operations on the Irish Sea, which have been severely impacted by the economic downturn' This is consistent with DFDS's representations to the OFT. See page 3 of DFDS' detailed company announcement No 24/2009 of 17 December 2009: 'DFDS creates Northern Europe's leading sea-based transport network').The link to this announcement is:
https://newsclient.omxgroup.com/cds/DisclosureAttachmentServlet?showInline=true&messageAttachmentId=286997

Irreversibility of the exit decision

56. Although the Board decision to exit the Fleetwood-Larne route was taken, and minuted, in September 2009, it not clear that this decision was irreversible or final at this point. Firstly, at that meeting, the minutes say that the Board asked that Stena come back to the next Board meeting with a clear plan for exit. The next time that the Board was provided with a presentation on this route was March 2010[43], at which point the evidence available to the OFT indicated that the issue for discussion had been widened to include looking at whether there were any alternatives to exiting this route. Although the presentation concludes that exit is in fact the most profitable option, the fact that it looks at other options is suggestive that the September 2009 decision to exit was not necessarily irreversible or final.

57. Secondly, it took Stena 15 months to close the route, with the announcement of closure happening the day after the completion of the merger. If the decision to close the route had been taken irreversibly in September 2009, it is not immediately clear why there should have been so big a delay in its implementation. Stena suggested three reasons. First, it had some 'flexibility' until the decision needed to be implemented.[44] Secondly, Stena was ready to incur some costs (for example, not terminating the Larne port contract early) to mitigate any potential commercial damage from its closure decision. And thirdly, the opportunity of acquiring the Target routes shifted the priorities on timing—although Stena emphasises that this should not be read as suggesting that the route closure and the merger were in any way linked.[45]

58. Given both the cautious approach that the OFT is compelled to take and the weight of evidence to the contrary, the OFT does not find the evidence sufficiently compelling that the decision taken in September 2009 was really final or irreversible, or that the unfolding of events in respect of the current

[43] See footnote 38 above.
[44] This meant that while the closure decision was made in September 2009, it was not immediately necessary to cease trading. Some time was available to consider possible alternative services to Fleetwood-Larne. Mr McGrath's oral representation at the Issues Meeting at the OFT of 19 January 2011 referred, for example, to the deadline for serving the termination notice in connection with the Fleetwood port agreement (end of June 2010).
[45] For example, in its recent *Dorf Ketal/Johnson Matthey* case, the OFT did not accept the inevitable exit of a business division in part because it was run for several years despite it being loss making (raising doubts as to how imminent exit was) and because the evidence submitted on exit did not pre-date discussions about the merger (raising doubts as to how independent of the merger exit was). See *Anticipated acquisition by Dorf Ketal Chemicals AG of the titanate and zirconate business of Johnson Matthey plc*, Case ME/4681/10, 19 November 2010, paragraph 23.

acquisition did not influence Stena's Board decisions of March, April[46] and June 2010.[47]

The route was loss making with no prospect of improvement

59. Stena has argued that the decision to exit the route was based on its negative forecast financial performance and the high capital investment required to maintain operations on the route, as well as enhanced competition from Seatruck on the diagonal routes. In support, Stena supplied to the OFT an 'Economic Review of Stena's decision to close Fleetwood/Larne' prepared by Frontier Economics in November 2010. This report assessed whether the decision to close this service was based upon sound economic judgment and analysis and whether the financial evidence in and underlying the presentations to the Board of Directors of Stena supported the decision to close Fleetwood-Larne. The report concludes that it does.[48]

60. The witness statements explain that a decision needed to be made in respect of the Fleetwood-Larne route, given the age of the vessels at that time operating on that route. These were becoming unreliable and unattractive for passengers, as well as very costly to run. Consequently there was an urgent need to start construction of new vessels if this route were to continue. That decision had to be made in 2010 at the latest. Stena told the OFT that the inherent restrictions of Fleetwood port mean that replacing vessels would be expensive. This port was also expensive to use since it needed regular dredging.

61. Having identified that the route was no longer profitable and had started to drain cash from the division, Stena looked at several options for dealing with the problem. Stena explained to the OFT that underperformance on the Fleetwood–Larne route which had been under observation for some time and had resulted in a financial review in 2009. This is Stena's standard practice and has been implemented on several other underperforming routes.

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[46] See footnote 39 above.
[47] See footnote 40 above.
[48] *Profitability of alternative options on the Fleetwood/Larne route- an economic review of Stena's decision to close Fleetwood/Larne (Frontier Economics)* November 2010 (Page 1).

62. The options that Stena considered were: i) closing the route; ii) using fewer vessels on the existing route; iii) moving two of the vessels on the route to different routes; iv) investing in new vessels for this or other alternative routes; and v) various combinations of these options. This analysis of alternatives does not appear to have considered the merger as an option. As presented to the Stena Board[49] on 26 April 2010, Stena's financial analysis suggested that closing the route was the least costly option.

OFT assessment of the financial position of the route

Negative financial forecast

63. The evidence available to the OFT indicates that the performance of the route started to decline in 2008. This appeared to be caused initially by rising [ ] costs. In addition a large spike in fuel costs for the year, combined with Stena's [ ], pushed the route into a loss making position despite rising revenue. Cost continued to rise in 2009 and 2010 further degrading performance on the Fleetwood-Larne route. The bulk of these increases in cost were caused by [ ]. In addition, the performance of the route in 2009 and 2010 was worsened by a sudden reduction in revenue, caused by a fall in freight revenue of over £[ ] between 2008 and 2010. This coincides with the impact of the economic downturn and Seatruck's expansion on Heysham-Larne in the 'diagonal corridor'.

[49] Stena Line Executive Board. The OFT understands this is the most senior board of Stena Line's ferry businesses.

64. The OFT notes that the financial forecasts prepared for the September board meeting[50] show that it would have been unprofitable to continue running the Fleetwood-Larne route. Continuing to run existing ships on the route was predicted to be unprofitable in 2010 and 2011. Reinvesting in new ships to run on the Fleetwood-Larne route (the 'Fleetwood max' option) would have remained unprofitable until 2014. However, the OFT considers that other evidence provided by Stena shows that exit was not inevitable for financial reasons. In particular:

64.1. the fact that the capital investment in the acquisition of vessels was foreseeable when Stena acquired the Fleetwood-Larne route in 2004;

64.2. Stena's overall financial strength;

64.3. the comparison with decisions taken in relation to other loss making routes; and

64.4. the availability of alternative options that do not appear to have been considered by Stena.

Substantial capital investment in the acquisition of new bespoke vessels

65. When it acquired this route in 2004, Stena was likely to have been aware of the restrictions of Fleetwood port, the age of the vessels and the capital investment which would be required in new vessels in the medium term. Stena told the OFT that its original business plan for the route envisaged it operating for seven years (that is, until 2011) before this capital investment was needed. Accepting that the financial downturn and Seatruck's capacity increase on the diagonal routes might have exacerbated these problems, it is nonetheless unclear to the OFT why—in Stena's submission—'ongoing operation of the route would be commercially irrational in all projections.'

[50] Stena's presentation titled *Closure of Fleetwood-Larne*, September 2009, prepared for the meeting of the Stena Line Holding BV board.

Overall financial strength of the Stena Group

66. The OFT's financial analysis of Stena's global operations revealed that in 2009, despite the financial downturn, it earned profits of €[ ]. Set against these profits, the forecast losses for 2010 on this route are €[ ] and add up to €[ ] (in the worst case scenario presented by Stena) by 2014. In light of Stena's overall financial health, the evidentiary threshold for an 'inevitably exiting division defence' must necessarily be higher than for an 'inevitably exiting firm defence'.[51]

67. The OFT did not receive compelling evidence of why Stena decided not to financially support the Fleetwood-Larne route when it was capable of—and had—supported other loss-making routes. This is particularly significant in a sector where, according to Mr Blomdahl (Stena Line (UK) CEO) [ ].[52]

Comparison with other loss making routes

68. Further, in comparing Fleetwood-Larne with the position on other routes, the OFT notes that, for example, the [ ] route has comparably poor financial performance but has not been closed. Stena explained to the OFT that, of the options considered for [ ], keeping the route open was expected to be more profitable than closing it, unlike Fleetwood-Larne. Stena explained that one of the reasons for differentiating [ ] from Fleetwood-Larne was that [ ].

69. In this regard, however, the OFT notes that the financial information for [ ] for 2010 supplied in the parties' response to the OFT's issues letter indicated that the route made a loss of £[ ]. On this basis, a failure by Stena to [ ] would appear to reopen the question of the viability of the [ ] route. Stena told the OFT that '[ ]'. By the end of 2012, when Stena may give consideration to closing [ ], Stena's forecasts suggest that it will have been loss-making for five years, whereas Fleetwood-Larne made actual losses for only three years before Stena closed it.

70. The OFT considers that the situation on the [ ] route indicates that Stena does not make decisions on routes purely on the basis of their short term financial performance but also for wider strategic reasons. In the issues

[51] See *Tesco/KwikSave*, paragraph 13.
[52] Item 10/16 of the minutes of a meeting of the board of directors of Stena Line (UK) Limited as supplied to the OFT on 7 December 2010.

meeting, Stena said [ ].[53] To the OFT, this contrasted with Stena's argument that Fleetwood-Larne was closed primarily because it was making a massive financial loss.[54]

71. In light of this, the evidence available to the OFT is not sufficiently compelling that, in contemplating the closure of Fleetwood-Larne, Stena's decision was purely financial and did not take account of its usual consideration of wider strategic reasons, including the possibility of this merger.

Availability of other alternative routes

72. Stena's board considered several options for the Fleetwood–Larne route; closure, continuing on the route (with or without investment in new boats) and continuing on a different route (with or without investment in new boats).

73. In order to compare options of different lengths and with different payout schedules Stena used net present value (NPV) analysis. This evaluates an option by estimating the net cash flows in each period and weighting earlier cash flows more heavily than later cash flows. The weighting—that is, the rate at which cash flows are discounted—depends on the opportunity cost of the money invested. This is known as the cost of capital. For Stena this is [ ] per cent. A firm that must choose between projects with NPVs above zero should choose the option with the highest NPV. A firm that must choose amongst projects with NPVs below zero should choose the option with the NPV closest to zero.

74. The various options considered by Stena include all the net cash flows from operations (with the exception of closure). For those options that include reinvestment Stena also includes this upfront cash outflow in the calculation. This includes purchase of new vessels or investments in port upgrades and is not discounted in the analysis because it must be paid upfront.

75. Some of the options considered by Stena have a positive NPV at an operational level but become unprofitable (have a negative NPV) when the investment needed to exercise the option is included. In other words, moving

[53] Response to the Issues Letter, paragraph 3.21.
[54] Response to the Issues Letter, paragraph 2.7.

to a new port is a profitable option in some cases except that doing so requires an upfront investment.

76. Consequently, Stena's analysis forecast [ ].[55] The OFT was therefore unsure why Stena had not considered alternative routes and ports in an attempt to find a profitable opportunity that did not require as much upfront investment. This is not least because the financial presentation to the Board identifies ports at [ ]—competing ports where Stena submitted that barriers to entry are low[56]—and that Stena attributed the poor financial performance of Fleetwood-Larne in part to competition from a service to Warrenpoint.

Enhanced competition from Seatruck

77. Stena has argued that one of the rationales for its exit from the diagonal corridor has been the enhanced competition it was facing from Seatruck. In fact, however, Seatruck only introduced its Heysham-Larne route in May 2010. So it is not entirely clear why this would have anything other than limited impact at the time of Stena's decisions in September 2009 and the first quarter of 2010.

78. Overall, given both the cautious approach that the OFT is compelled to take and the weight of evidence to the contrary, the OFT does not find the evidence sufficiently compelling that exit was inevitable for financial reasons and that there were no alternatives other than to exit.

Steps taken to close the route

79. Stena told the OFT that there were clear examples of actions showing its determination to pull out of the Fleetwood-Larne route regardless of the merger. In particular:

79.1. consultancy undertaken by [ ] for Stena in May 2010;

79.2. serving the termination notice on Associated British Ports with regard to the Fleetwood port agreement on 9 June 2010;

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[55] Stena's financial analysis indicates that [ ].

[56] In the context of Stena's view in its original submission to the OFT that access to berths was not a barrier to entry for competing services to Fleetwood-Larne, Stena submitted that 'a project has been put forward to [ ]'.

79.3. gathering contact details and availability of Stena managers on the Fleetwood-Larne route in August 2010;[57]

79.4. cancelling necessary supplies (such as bespoke spare parts for the vessels) and failing to book dry-docking for annual maintenance contracts for the vessels on Fleetwood-Larne in October 2010; and

79.5. the closure of the route on 24 December 2010.

80. Each is discussed below.

[ ] consultancy

81. Stena submitted that it instructed [ ] management consultancy to [ ].

82. However, the instruction to [ ] to [ ] (on or around 16 August 2010)[58] does not pre-date discussions—advanced by the stage—of the merger by Stena and DFDS.[59] In the light of this, the OFT is unsure whether Stena's instructions to [ ] are a clear example of its determination to pull out of Fleetwood-Larne regardless of the merger.

83. Further, the OFT understands that [ ][60]. In the light of this, it is unclear to the OFT whether Stena's instruction to [ ] was related to any decision by Stena to [ ] as well as, or instead of, its decision to exit Fleetwood-Larne (which, as mentioned above, is not clearly uninfluenced by the merger).

Serving the termination notice on Associated British Ports

84. The deadline for Stena to serve notice of the termination of its contract with Associated British Ports (ABP) in respect of Fleetwood was 30 June 2010. Stena served the notice on 9 June 2010. It told the OFT that knowledge of its intention to terminate the contract was restricted to a limited number of senior managers to [ ]. For this reason, Stena submits, the OFT has not

[57] Source: email titled 'FW: Managers on Fleetwood-Larne route' attached to the email titled 'Further evidence' of Tuesday 7 December 2010.
[58] File name: 'Ship management - TWNW wk 32.xlsx' as submitted with explanatory narrative by Stena to the OFT by email of 7 December 2010.
[59] The OFT notes that at the beginning of August 2010, the parties were already discussing Heads of Terms, which would be the basis for the final negotiations concerning the Sale and Purchase Agreement.
[60] [ ].

been able to verify with third parties that steps were being taken before its contemplation of the merger to close the route.

85. A third party has commented that serving a termination notice particularly in the current financial environment is often used to re-negotiate better terms for the remainder of the contract period. Stena said that this is certainly not standard market experience in its experience as it would sour commercial relations between contractual parties. But the OFT has received evidence from Stena and other third parties showing examples where re-negotiations have taken place.

86. Further, the OFT was presented with email correspondence between Stena and ABP discussing the termination notice, which ABP told the OFT that it took to mean that Stena intended to renegotiate the contract. Stena told the OFT that [ ]. From the OFT's interpretation of the email correspondence, either interpretation appears plausible. Consistent with ABP's interpretation, however, the email correspondence revealed that ABP and Stena had already [ ] prior to Stena serving notice.

87. Lastly, as with Stena's award of the [ ] consultancy project, Stena's termination notice to ABP does not pre-date detailed discussions about the merger.

<u>Gathering contact details and availability of Stena managers</u>

88. Stena explains that '[t]his was done in anticipation that an agreement might have been reached with DFDS in early August and that Stena would be then be able to close the Fleetwood/Larne route and minimise its losses.'[61] At that point in time the parties were aiming to sign the sale and purchase agreement for the merger in September.[62]

89. As with some other actions discussed, this action does not pre-date discussions about the merger.

[61] Response to the additional information request received on 8 December 2010, page 25.
[62] Source: record of a meeting on 10 August 2010, as described in chronology enclosed as 'Schedule 2-Question 8' of Response to additional information request received on 8 December 2010, page 29.

Cancellation of supplies

90. Stena submitted emails confirming the cancellation of some spare parts (21 and 28 October 2010). The OFT notes that by then, 'heads of terms' for this merger had already been agreed (24 August 2010), due diligence was progressing and a target date for singing had been set (26 November 2010).[63] As with some other actions discussed, therefore, this action does not pre-date discussions about the merger.

91. Stena also gave as an example [ ]. Stena pointed out the different termination periods agreed in two fairly similar contracts, Fleetwood being substantially shorter in contemplation of the impending (albeit not yet announced closure). However, as stated above, at that time, the discussions with DFDS had already commenced and were heading to a meeting on 10 August 2010, in which the objective was to discuss and negotiate the Heads of Terms and the due diligence process.

92. In both cases, the OFT cannot dismiss on the basis of its 'it may be the case standard' that both actions were influenced by the advanced negotiations about this merger.

Closure of the route on 24 December

93. Stena submits that the closure of the route as scheduled on 24 December 2010 clearly indicates its commitment to cease operating it.

94. However, the OFT notes that the main beneficiaries of the closure of this route were expected to be the Target routes, inasmuch as the great majority of the diversion from Fleetwood-Larne following its closure was expected by Stena (from its internal documents) to go to them. The closure of Fleetwood-Larne led to a capacity reduction in ferry services in the Irish Sea. This had been identified by competitors[64] and even some large customers as damaging financial results.

95. On this basis, the OFT is unable to determine whether Stena's closure of the route indicates an intention to reduce capacity on the Irish Sea in as

[63] Signing and completion eventually took place on 1 December 2010.
[64] For example, a DFDS board presentation of 24 March 2010 estimates that [ ]. Likewise, [ ]. [ ] (See response to the OFT questionnaire by letter of 22 December 2010).

beneficial way as possible to Stena at least as much as a commitment to cease operating Fleetwood-Larne.

Conclusion on the inevitability of Stena's exit from Fleetwood-Larne

96. Stena has provided a significant amount of material in support of its proposed counterfactual. However, the OFT will not lightly depart from judging the impact of a merger against pre-merger conditions, and will only do so when it has sufficient compelling evidence that exit is inevitable. It would be perverse to subject a prima facie problematic sale of a non-distressed business to a lesser standard of scrutiny by accepting more easily that exit was inevitable when the business itself is not at or near the point of failure.

97. On the basis of the above, the OFT cannot conclude with a sufficient degree of certainty that Stena would have inevitably closed the Fleetwood-Larne route and consequently exit the diagonal corridor market, absent the merger.

98. Although the first limb of the exiting firm (division) test has not been satisfied, the OFT has for completeness gone on to consider whether the remaining limbs would be met.

Whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration

99. Stena has submitted that the only reference to the Target routes was in the form of a brief query from Stena to DFDS. Conversely, DFDS told the OFT that it asked Stena about the possibility of acquiring Stena's Irish Sea routes but that Stena was not willing to sell. This is consistent with [ ]'s statement that '[Stena] never seriously considered selling the route as [Stena] knew that there was no hope of finding a purchaser for a route with such old vessels and such unprofitable forecasts.'

100. Although it is not necessary for the OFT to conclude on this second limb of the exiting division defence in light of the evidence as stated in paragraph 99 above, the OFT cannot exclude the possibility that Stena might have sold that route to another ferry operator and this could have led to a potentially less anticompetitive outcome.

101. The OFT therefore considers that the second limb of the exiting firm test has not been met.

What would have happened to the sales of the firm in the event of exit

102. The transaction is completed and freight and passenger ferry services across the 'diagonal corridor' have been operating without Fleetwood-Larne since the beginning of 2011. This provides an initial view of the situation without Fleetwood-Larne, albeit one (according to third parties) covering a very limited period, soon after a holiday period, following the unexpected closure of an important service and prior to further capacity reductions and possible price increases in other routes.

103. Noting these caveats, the OFT observes that most third parties expect a substantial proportion of the traffic to move to other routes in the 'diagonal corridor', with a substantially smaller amount of traffic being re-routed to the Scottish short routes into Belfast and short middle corridor routes from Holyhead. A much smaller group of customers told the OFT that they would consider diverting some traffic to routes to Dublin or much longer services from continental Europe.

104. In light of this, the OFT considers that absent the merger, the majority but not all of the Fleetwood-Larne traffic would have remained in the diagonal corridor meaning that it would have been likely to be dispersed across several competitors. This means that, by transferring most or all of that business to Stena, the merger may well have had a significant effect on competition. Therefore, the OFT considers that the third limb of the exiting firm test has not been met.

Closure of DFDS's retained routes

105. On 13 January 2011, DFDS announced that it was closing its Liverpool-Dublin and Heysham-Dublin routes and, therefore, exiting the Irish Sea all together. In a public announcement[65], it stated that after having considered several options, it had concluded that this was the only possible outcome. DFDS confirmed this to the OFT. The OFT is also aware that DFDS and Stena [ ].[66] Several competitors and customers foreshadowed DFDS's decision in their responses to the OFT during its investigation of this merger, saying that they did not think that DFDS would have the necessary economies of scale and financial incentives to stay operating in the Irish Sea following Stena's acquisition of its routes in the 'diagonal corridor'.

106. For the purpose of this investigation, however, it has not been necessary for the OFT to conclude on whether [ ].

Conclusion on the counterfactual

107. Since the OFT does not have compelling evidence that the three limbs of the exiting firm (division) scenario have been satisfied, the OFT has assessed the merger against the pre-merger counterfactual that, absent the merger, both parties would have continued to operate ferry services in the 'diagonal corridor'.

[65] See at http://www.dfds.com/news/latest/20110113_1/ .
[66] See paragraph 4 above.

108. Further, for completeness, the OFT has also considered counterfactuals with and without taking into account the announced closure of DFDS Dublin routes when considering possible theories of harm involving other Irish Sea corridors.

THEORIES OF HARM

109. The OFT has considered the following theories of harm:

109.1. unilateral effects in the supply of freight ferry services in the diagonal corridor;

109.2. unilateral effects in the supply of passenger ferry services in the northern corridor;

109.3. unilateral effects due to the loss of potential competition from Stena in the diagonal corridor; and

109.4. unilateral effects in the supply of freight ferry services in the northern corridor.

HORIZONTAL ISSUES

Introduction

110. The primary concern expressed by freight customers results from the loss of rivalry between two of the three ferry operators active in the diagonal corridor, although other concerns expressed related to Stena's post-merger position across a wider set of Irish Sea routes.

111. Stena submitted that in considering market share data the OFT should either define the market narrowly enough to reflect actual competitive constraints, or be aware of the binary fallacy in relation to any wider market definition and consider where close competition exists within that market. Consistent with this latter point, the OFT notes that when interpreting information on market shares and concentration the OFT may have regard to the extent to

which products are differentiated and some products are closer competitors to each other than to others.[67]

Market shares

Freight services

112. The use of freight volumes as the principal means to calculate market shares (rather than revenues or capacity) is consistent with the CC's Irish Sea report.[68] Volume-based market shares for routes in the diagonal corridor for 2009 are given in the table below.

Freight ferry service volume-based market shares for the diagonal corridor, 2009[69]

Operator	Route	Accompanied units	Unaccompanied units	Total freight units	Share, per cent
Stena	Fleetwood-Larne	[ ]	[ ]	[ ]	[25-35]
DFDS	Liverpool-Belfast	[ ]	[ ]	[ ]	[30-40]
	Heysham-Belfast	[ ]	[ ]	[ ]	[10-20]
	All DFDS	[ ]	[ ]	[ ]	[45-55]
Seatruck	Heysham-Warrenpoint	[ ]	[ ]	[ ]	[15-25]
	Heysham-Larne[70]	-	-	-	-
TOTAL		[ ]	[ ]	[ ]	100

113. Under the counterfactual adopted by the OFT of the pre-merger situation, the merger reduces the number of operators from three to two and the merger gives Stena and DFDS a combined market share of [75-85] per cent. This is high enough to give the OFT prima facie cause for concern over unilateral effects. In addition, the transaction leads to almost a monopoly (over [85-95] per cent) in the supply of accompanied freight services since Seatruck's share of accompanied traffic is very limited.

114. The OFT is conscious that these market shares represent a snapshot of the diagonal corridor and do not take account, for example, of Seatruck's entry

[67] See further paragraph 5.3.2 of the Merger Assessment Guidelines.
[68] See footnote 25 of the CC Irish Sea report.
[69] Source: Table 1 of Schedule 15 of the Submission.
[70] Route started in May 2010 with one vessel; expanded to two vessels in October 2010.

on the Heysham-Larne route. Stena submits that accounting fully for Seatruck's Heysham-Larne service would increase Seatruck's forward-looking share of freight volumes on diagonal routes to at least 30 per cent. Consistent with this, volume data provided by Seatruck suggests that by the final months of 2010 it may have accounted for around [20-30] per cent of diagonal traffic. Nonetheless, even if Seatruck's expansion were to increase its market share on the diagonal corridor to at least 30 per cent, the combined Stena and DFDS (under the OFT's counterfactual) would still have up to 70 per cent of the market. This remains high enough to give the OFT prima facie cause for concern over unilateral effects.

115. The table below shows 2009 freight volumes and shares on the wider northern corridor. As shown in this table, in 2009 Stena and the Target accounted for [50-60] per cent of freight volume on the northern corridor. This is high enough to give the OFT prima facie cause for concern over unilateral effects. Moreover, regardless of which counterfactual is used (i.e. even excluding Stena's Fleetwood-Larne route entirely), the transaction reduces the number of freight ferry operators on the northern corridor from four to three (Stena, P&O and Seatruck). For accompanied traffic, it is effectively a three to two merger, given the very limited share of Seatruck in such freight traffic.

Freight ferry service volume-based market shares for the northern corridor including Fleetwood-Larne, 2009[71]

Operator	Route	Accompanied units	Unaccompanied units	Freight units (volume)	Share, per cent
Stena	Fleetwood/Larne	[ ]	[ ]	[ ]	[10-20]
	Stranraer/Belfast	[ ]	[ ]	[ ]	[10-20]
	All Stena	[ ]	[ ]	[ ]	[25-35]
DFDS	Liverpool/Belfast	[ ]	[ ]	[ ]	[15-25]
	Heysham/Belfast	[ ]	[ ]	[ ]	[5-15]
	All DFDS	[ ]	[ ]	[ ]	[25-35]
Seatruck	Heysham/Warrenpoint	[ ]	[ ]	[ ]	[5-15]
	Heysham/Larne[72]	-	-	-	-
P&O	Cairnryan/Larne	[ ]	[ ]	[ ]	[25-35]
	Troon/Larne	[ ]	[ ]	[ ]	[0-10]
	All P&O	[ ]	[ ]	[ ]	[25-35]
TOTAL				[ ]	100

[71] Source: Table 2 of Schedule 15 of the Submission.
[72] Route started in May 2010 with one vessel; expanded to two vessels in October 2010.

116. The table below sets out Stena's estimates of volume and market share for 2010[73], taking into account the closure of Fleetwood-Larne and re-allocating its traffic based on Stena's assumptions and estimates. The estimates also take account of Seatruck's entry onto the Heysham/Larne route. Based on these estimates, post-merger freight shares on the northern corridor would be: Stena [40-50] per cent (with an increment of [10-20] per cent), P&O [25-35] per cent and Seatruck [15-25] per cent. Again, this is high enough to give the OFT prima facie cause for concern over unilateral effects.

Freight ferry service volume-based market shares for the northern corridor excluding Fleetwood-Larne, 2010 (based upon Stena's expectations)

Operator	Route	Accompanied units	Unaccompanied units	Freight units (volume)	Share, per cent
Stena	Stranraer/Belfast	[ ]	[ ]	[ ]	[10-20]
	Liverpool/Belfast	[ ]	[ ]	[ ]	[20-30]
	Heysham/Belfast	[ ]	[ ]	[ ]	[5-15]
	All Stena	[ ]	[ ]	[ ]	[40-50]
Seatruck	Heysham/Warrenpoint	[ ]	[ ]	[ ]	[5-15]
	Heysham/Larne	[ ]	[ ]	[ ]	[5-15]
	All Seatruck	[ ]	[ ]	[ ]	[15-25]
P&O	Cairnryan/Larne	[ ]	[ ]	[ ]	[25-35]
	Troon/Larne	[ ]	[ ]	[ ]	[0-10]
	All P&O	[ ]	[ ]	[ ]	[25-35]
TOTAL		[ ]	[ ]	[ ]	100

117. Considering all routes to and from Northern Ireland and the Dublin area together, and accounting for the closure of Fleetwood-Larne, Stena estimated[74] that its post-merger share of freight volume would be [30-40] per cent (with an increment of [15-25] per cent). In a market where products were undifferentiated—provided that market was defined to be the narrowest containing the parties' routes[75] to satisfy the hypothetical monopolist test[76]—this would not often give the OFT cause for concern over unilateral effects.[77] However, given that customers consistently told the OFT that some routes are substantially closer substitutes to each other than are other routes, the OFT would not necessarily dismiss competition concerns on

[73] Based on Table 4 at Schedule 14 of the Submission.
[74] See Tables 3 and 4 of Schedule 14 of the Submission.
[75] See Merger Assessment Guidelines, paragraph 5.2.11.
[76] See Merger Assessment Guidelines, paragraph 5.3.1.
[77] See Merger Assessment Guidelines, paragraph 5.3.5, first bullet.

the basis of this market share, even if its assessment were made on a wider Irish sea market. In any case, Stena's estimated shares do not take into account the exit of DFDS from its Dublin routes at the end of January 2011, which leaves four remaining competitors on these routes (P&O, Stena, Seatruck and Irish Ferries).

Passenger services in the northern corridor

118. In the northern corridor, DFDS's Liverpool-Belfast passenger ferry service overlaps with Stena's Stranraer-Belfast and (under the counterfactual adopted by the OFT) Fleetwood-Larne passenger ferry services. The merger would lead to a reduction from three to two in the number of passenger ferry operators from/to Northern Ireland and—from the table below—gives an estimated combined volume-based market share of [60-70] per cent with an increment of [5-15] per cent. This is high enough to give the OFT prima facie cause for concern over unilateral effects.

Passenger ferry service volume-based market shares for the northern corridor, 2009[78]

Operator	Route	Passengers carried	Share per cent
Stena	Stranraer/Belfast Fleetwood/Larne All Stena	[ ] [ ] [ ]	[50-60] [0-10] [50-60]
DFDS	Liverpool/Belfast	[ ]	[5-15]
P&O	Cairnryan/Larne Troon/Larne All P&O	[ ] [ ] [ ]	[20-30] [5-15] [30-40]
TOTAL		[ ]	100

[78] Source: Table 1 of Schedule 15 of the Submission.

119. For all passenger routes between Great Britain and the island of Ireland, including the Central corridor routes (these are to and from Dublin-area ports), Stena estimates that its post-transaction combined share is [50-60] per cent, with an increment of only [0-10] per cent. On this basis, the candidate market for passenger services between Great Britain and the island of Ireland is not considered further.

Unilateral effects

Freight services in the diagonal corridor

120. As noted by the CC in its Irish Sea report, pricing terms for freight ferry services are opaque. For most customers they are set by bilateral negotiation for a forward-looking period, based on a number of factors. The CC concluded that there is significant scope for price discrimination between customers.

121. In Stena's view, the OFT should focus on assessing the level of head-to-head competition between routes with similar characteristics (such as duration, frequency and cost) rather than focus on attempting to define any markets and estimate different levels of concentration or market shares. Stena submits that the above factors represent the main competitive drivers in the ferry markets.

122. Consistent with Stena's view, the OFT considers that the boundaries of the market do not determine the outcome of its analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the OFT may take into account ways in which some constraints are more important than others (see paragraph 31 for example). That said, as part of its assessment of the effects of a merger on competition, the OFT may use market shares and measures of concentration, given its role as a Phase I body and the limited time available for its review. To the extent the OFT takes a view on whether market shares are 'high' or 'low' (that is, in comparison to thresholds), it does so only when markets are defined to be the narrowest satisfying the hypothetical monopolist test (see paragraph 117). In this case, that market looks to be the diagonal corridor—so it is appropriate for the OFT to have regard to market shares there.

123. In addition to evidence on market shares on the diagonal corridor, Stena submitted specific customer switching data for the first two weeks of January 2011 following the closure of the Fleetwood-Larne route. The OFT also sought similar information from competitors and large customers. The responses to the OFT's third party inquiries showed a wide range of customer needs and alternatives. Nonetheless, most customers using the routes in the diagonal corridor told the OFT that their best alternative was another diagonal corridor route. Some told the OFT that, if faced with capacity constraints or significant price increases, they would consider alternative routes not in the diagonal corridor. Yet the majority of third parties who responded to the OFT did not consider that switching from diagonal corridor routes to routes from Loch Ryan in Scotland to be a cost-effective alternative (for fuel and driver-time cost considerations) unless rates for diagonal crossings were to increase very significantly. Consistent with this, customers told the OFT that they benefitted directly from competition between Stena and the DFDS routes in the diagonal corridor.

124. Further, data provided by Stena on its understanding of which routes individual former Fleetwood-Larne freight customers had transferred to since the services closed indicated that the great majority had switched to other diagonal routes, and that a large proportion (27 out of 43 listed) had switched at least some volumes to the acquired routes, implying a significant diversion ratio between the merging parties. This is consistent with information gathered by the OFT from a number of customers. However, as stated above (see paragraph 102), the OFT considers it appropriate to treat this estimate with caution given the short timeframe and seasonal traffic fluctuations.

125. Whilst Seatruck has a degree of spare capacity to absorb traffic switching away from the Fleetwood-Larne route or the acquired routes, it is not clear to the OFT that its effective spare capacity would be sufficient to accommodate the business diverted away from the parties and therefore to constrain the merged entity's pricing (and other) conduct to an extent equivalent to the pre-merger conditions of competition.

126. Moreover, for accompanied freight, Seatruck allocates only around 10 per cent of its capacity to accompanied traffic on the diagonal corridor and has only limited ability to expand provision due to the design of its ships. Other than potentially switching to unaccompanied freight, customers' best

alternatives to the merging parties' routes for accompanied freight may well be routes via Loch Ryan or Holyhead. As such, the impact of the merger may be expected to be more significant for accompanied freight, since post-merger Stena will have the vast majority of capacity for accompanied freight on the diagonal corridor.

127. Overall, therefore the OFT concludes that the merger raises substantial competition concerns with regard to the supply of freight ferry services in the 'diagonal corridor', in particular in relation to accompanied traffic.

Passenger services in the northern corridor

128. As discussed above, the merger would reduce the number of ferry operators in the northern corridor offering passenger services to and from Northern Ireland from three to two and would give Stena a market share of [60-70] per cent with an increment of [5-15] per cent.

129. The choice of counterfactual is unlikely to be decisive in the assessment of the market for passenger services since Stena's Fleetwood-Larne service carried only a small number of passengers (less than [ ] in 2009) and accounted for only a very small fraction of Stena's market share.

130. Despite this, several third parties have raised concerns about the overall market shares Stena has in the supply of passenger services in the northern corridor. However, Stena submitted that in terms of both its location and its scale of operation for passengers, P&O's Loch Ryan services would appear to be a much closer and stronger competitor to Stena's Stranraer-Belfast route than is the acquired Liverpool-Belfast route, and that therefore the impact of the merger on passenger services in the northern corridor is significantly lower than the simple market shares would suggest.

131. The OFT has not needed to conclude on this point given that its reference test is met with regard to unilateral effects in freight ferry services in the diagonal corridor.

Loss of potential competition in freight services in the diagonal corridor

132. Even if the OFT were to accept that Fleetwood-Larne route would inevitably have closed absent the merger, and therefore that this is the appropriate counterfactual against which to assess the merger, there is cause for concern over the loss of potential competition in freight services in the corridor. Absent the transaction, DFDS's and Seatruck's conduct (pricing, frequencies, etc.) may have been constrained by the prospect that Stena might have sought to (re-)enter the diagonal corridor if competitive conditions (and profitability) improved such as to make entry attractive. Such re-entry would not necessarily need to be on the Fleetwood-Larne route. One third party noted that it is relatively easy and common to re-start a closed route and that there were plenty of such examples (giving the example of the Cork-Swansea route, which closed in 2006 but restarted in 2010). Consistent with this, Stena submitted that access to berths was not a barrier to entry for competing services to Fleetwood-Larne (see paragraph 76).

133. The transaction removes the prospect that Stena would represent a significant potential entrant, with an established track record operating in the diagonal corridor. It appears less likely that DFDS would fulfil an equivalent role following the sale of its Belfast routes and assets, and overall exit from the Irish Sea. Stena's past behaviour and the current transaction indicate to the OFT a strategic business priority and illustrate to the OFT the value placed by Stena on being able to offer ferry services in the diagonal corridor to its freight customers to complement its other ferry services (such as the shorter Loch Ryan and central corridor routes).

134. Stena confirmed that it considers it to be commercially desirable to offer a service on the diagonal routes, but re-iterated its submissions on the counterfactual, that absent the transaction it would have no financial incentive in the short-medium term to enter the diagonal routes. It submits that P&O is at least as likely an entrant as Stena, especially given its ownership of the port of Larne. It also indicated that Seatruck would be a more likely new entrant or would be ready to expand its existing services with the arrival of some additional vessels expected to be delivered in the short term.

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135. Overall given the OFT's conclusion with regard to the counterfactual and consequent unilateral effects in freight ferry services in the diagonal routes, there is no need to conclude on this theory of harm.

Freight services in the northern corridor

136. The OFT has also examined the impact of this merger in the northern corridor, based on excluding the Fleetwood-Larne service from the counterfactual. In that case, the only merger overlap arises on a wider geographic basis between the Target routes and Stena's routes between Scotland and Northern Ireland.

137. Some third parties noted the previous use of this northern corridor as a relevant framework for competition assessment, and commented that capacity reductions on diagonal routes would 'force' some traffic to switch to using the Scottish routes.

138. There was some concern from customers that following the closure of Fleetwood-Larne, capacity constraints on diagonal routes (particularly for accompanied traffic) could be such that some volumes would be forced to divert to Loch Ryan routes (or, to a lesser extent, the Holyhead-Dublin route), including those operated by Stena. As noted above, Seatruck's diagonal services may not be regarded as a good alternative to the acquired routes for some freight customers given its limited capacity for driver-accompanied freight traffic, making the overlap between the acquired routes and Stena's other routes potentially more significant in terms of the scope for unilateral effects for accompanied freight. A number of third parties also expressed concerns that the transaction will leave Stena as the only freight ferry operator with services operating from/into the port of Belfast.

139. However, Stena has submitted internal analysis used for its business planning of the anticipated diversion by Fleetwood-Larne customers following the (then) prospective closure of the Fleetwood-Larne route. The analysis assumes that the vast majority (more than 95 per cent) of traffic would switch to other diagonal routes, split between the acquired routes and those operated by Seatruck. Information supplied by Stena about its understanding of actual switching by Fleetwood-Larne customers since the route's closure was broadly consistent with Stena's prior internal analysis that most would seek to remain on diagonal routes, albeit the OFT believes that only limited weight can be placed on this short-term data (see paragraph 102 above).

140. The OFT accepts that in general the closest competition between ferry routes is likely to occur between closely located sets of routes – such as the diagonal routes, or the Scotland/Northern Ireland routes. The OFT also notes, however, the extremely high share of accompanied traffic on the diagonal routes accounted for by the Fleetwood-Larne and Liverpool-Belfast routes. Given that Seatruck's Heysham routes have very limited capacity for accompanied freight traffic, the next best alternative for a proportion of Liverpool-Belfast customers may be on other corridors.

141. Overall, though, given the OFT's conclusion with regard to the counterfactual and consequent unilateral effects in freight ferry services in the diagonal routes, there is no need for it to conclude on this theory of harm.

BARRIERS TO ENTRY

142. Analysis of a possible SLC includes consideration of the responses of actual and potential rivals to the merger. Entry by new firms (or expansion by existing firms) can mitigate the effect of the merger on competition.

143. The CC Irish Sea report identified the key requirements for entry into a freight ferry services as access to suitable ports, with appropriate berths, sufficient surrounding land and terminal buildings, all available at peak times, and access to a suitable vessel or vessels. In addition, the entrant must have sufficient financial strength to be able to make a medium- to long-term investment and must also be able to attract a suitably-located customer base.

144. The CC Irish Sea report considered that small-scale entry was unlikely to be viable, given the economies of scale required, and the need for a competitive freight operation to operate a daily timetable with peak and off-peak departures.

145. In assessing whether entry or expansion might prevent an SLC the OFT must consider whether such entry or expansion would be timely, likely and sufficient. In relation to the likelihood of entry, the OFT will consider whether entry is likely to take place if the entrant expects post-entry prices to be at pre-merger levels.

146. There was general agreement amongst third parties that there has been significant overcapacity in Irish Sea freight ferry services in recent years. Stena submitted that, 'the current wider economic uncertainty means that the main barrier to entry is the willingness of businesses to make the investment required to launch a service at a time when demand is flat (or falling), and the apparent overcapacity in the market means that existing routes are not profitable.'

147. The OFT considers that conditions in the market will determine the strength of any given set of barriers to entry, rather than constituting a barrier themselves.[79] That said, the recent economic conditions contributing to lower freight volumes and poor financial performance of existing Irish Sea routes, and prevailing capacity levels, are likely to directly influence the prospects for new entry in freight services on the diagonal corridor where the OFT has found that its reference test is met. New entry on the diagonal corridor would add capacity to the market and be likely to contribute to lower freight prices. Stena's contention that it would not have re-entered the diagonal corridor in some form absent the merger is consistent with market conditions making pre-existing barriers to entry less surmountable.

148. Third party comments are also consistent with this. One third party commented that the scope for entry is driven by marketplace performance and demand, and that an entrant would need to see growth prospects. It indicated that the financial commitments involved are too large to try moving vessels between routes on a speculative basis. Another third party commented that there was vessel and berth availability to facilitate new entry, but that in the current conditions of overcapacity the market would need to recover before operators would make decision to deploy additional capacity.

149. Stena submitted that Seatruck and P&O were the most likely to overcome entry barriers. Seatruck told the OFT that its 2010 extension of its services to include the Heysham-Larne route was in large part driven by its excess vessel capacity and poor conditions in the ship charter market. Its expected losses were lower in operating the route than in leaving the ships idle. However, Seatruck told the OFT that it had suffered significant continuing losses on its Irish Sea operations.

[79] See Merger Assessment Guidelines, paragraph 5.8.4.

150. During the investigation no third party (including Seatruck and P&O) indicated to the OFT any interest in entering into or expanding freight services on the diagonal corridor. However, on 7 February 2011, Seatruck announced that it intends to introduce a new freight ferry service between Heysham and Dublin on 14 February.[80] It is unclear to the OFT whether this new service is a response to DFDS exiting its Dublin routes.

151. While this entry may be timely and is likely, its potential to restore the loss of competition in the supply of freight ferry services in the diagonal corridor may be limited for three reasons: i) although some freight customers may view the Heysham-Dublin route as an alternative to the diagonal corridor, most do not (see paragraph 26, for example); ii) it cannot cater for a large volume of accompanied traffic; and iii) some customers have questioned Seatruck's long term strategy in the diagonal corridor (and the Irish Sea more generally) because of its limited scale compared to other ferry operators and the fact that chartering ships is the core business of its parent company, not providing ferry services.

152. For these reasons, the OFT is unable to conclude that new entry (including Seatruck's announced entry in an adjacent market) or expansion would be sufficient to replace the competition lost as a result of this merger.

BUYER POWER

153. The CC Irish Sea report found that ferry operators were able to price discriminate between customers. Larger customers had more bargaining power than smaller customers and often got lower prices than them. The CC did not accept the parties' argument in that case that most customers had sufficient countervailing power to prevent the exercise of market power by ferry companies[81].

[80] See announcement at: http://www.seatruckferries.com/web/seatruck.nsf/content/News%20Article?OpenDocument&article=dwsc8dugfx

[81] CC Irish Sea report, paragraph 5.21.

154. Stena submitted that use of multiple ferry operators and examples of customer switching showed evidence of customers' buyer power. The OFT recognises that some customers may be able to leverage their switching options in their negotiations with ferry operators, but believes that there may be customers of relevant routes whose alternative options are narrow, and who would not be protected by the negotiating position of other customers.

155. The OFT is therefore not persuaded that countervailing buyer power would be sufficient to prevent the potential adverse merger effect identified.

THIRD PARTY VIEWS

156. Most third parties contacted expressed concerns regarding Stena's acquisition of the Target business and the contemporaneous announcement of the closure of its Fleetwood-Larne service.

157. Some customers focussed principally on the loss of competition between Stena's Fleetwood-Larne route and the acquired routes, and the implications of the reduction in capacity arising from the closure of the Fleetwood-Larne route. Other customers were also concerned that capacity constraints post-merger on routes in the diagonal corridor, in particular for accompanied freight traffic, would force traffic to divert to alternative less convenient routes including some of those currently operated by Stena (in particular the Stranraer-Belfast route).

158. One additional issue which has not been addressed above is the concern of a competitor that Stena would use its strong position in some of the corridors and enhanced position across the wider Irish Sea to leverage a competitive advantage, for example by bundling the provision of services in one corridor with those of other corridors. Given the OFT's conclusion that its reference test is met in respect of freight ferry services in the diagonal corridor, the OFT has not needed to conclude on this competitor's concern over the conglomerate aspects of the merger, save to say that it is a well-established principle that most non-horizontal effects are benign.[82]

[82] See Merger Assessment Guidelines, paragraph 5.6.1.

ASSESSMENT

159. Prior to this merger the merged parties overlapped in the supply of ferry services in the Irish Sea. Specifically, Stena and the Target both operated freight ferry services in the 'diagonal corridor' between the north west of England and Northern Ireland , and (to a lesser extent) passenger freight services in the 'northern corridor' between Scotland and the north west of England and Northern Ireland. The day after the merger was completed, Stena announced its decision to close its Fleetwood-Larne service.

160. At the time of this transaction, both Stena and DFDS (the former owner of the Target) operated other services across the Irish Sea. Since then, DFDS has announced that it intends to close its remaining services to Dublin and exit the Irish Sea. Stena's other Irish Sea ferry services continue to operate.

161. Consistent with OFT and CC precedents, this decision has considered that freight and passenger ferry services constitute separate product markets. The OFT's assessment has also considered accompanied and unaccompanied freight traffic separately but without reaching a conclusion on whether they constitute separate relevant markets.

162. On the basis of the competition that existed until the closure of Fleetwood-Larne, the narrowest relevant geographic market for freight ferry services appears limited to the diagonal corridor. As such, the OFT has primarily assessed the merger on this geographic market, while recognising that there may also be wider constraints from alternative corridors, in particular from the short routes between Scotland and Northern Ireland.

163. The OFT has not concluded on the precise geographic scope for the supply of passenger ferry services. Taking a cautious approach, it has assessed the impact of this transaction on the basis of the supply of ferry passenger services in the northern corridor.

164. As the UK's first phase merger control authority, the OFT must reach a decision based on the evidence before it, within a tight timeframe, taking a cautious approach. As such, the OFT will generally adopt the prevailing conditions of competition pre-merger as the counterfactual against which to assess the impact of the merger, unless there is compelling evidence to support diverting from this approach.

165. In the current case, a key issue was whether the appropriate counterfactual should incorporate the closure of Stena's Fleetwood-Larne route and consequent exit from the diagonal corridor. Based on the evidence available to it, the OFT was not persuaded, to the relevant standard, that the potential acquisition of the target routes did not influence Stena's decision to decide to close the Fleetwood-Larne route and consequently to exit the diagonal corridor. The OFT therefore cannot depart from assessing the competitive effects of the merger against the pre-merger situation.

166. Given the OFT's conclusion on the counterfactual, the main competition concern arises as a result of the reduction from three to two ferry freight operators in the diagonal routes, a market which was already highly concentrated. The estimated combined market of the merged company post-merger is 70-80 per cent, with a share of over 90 per cent for accompanied freight traffic, giving rise to substantial competition concerns on the basis of unilateral effects. Third party views and evidence on diversion between the parties have corroborated these concerns. The presence of the remaining competitor (Seatruck) may not be sufficient to constrain price increases resulting from this merger.

167. For completeness, the OFT has considered other alternative theories of harm based on a counterfactual involving Stena's inevitable exit from the diagonal corridor, However, it has not needed to reach a conclusion on these, given its conclusion that its reference test is met in respect of freight ferry services in the diagonal corridor under the counterfactual that the prevailing conditions of competition would have persisted absent the merger.

168. New entry and the threat of entry can also represent important competitive constraints on the behaviour of the merged entity. However, the entry must be timely, likely and sufficient in scale or character to replicate the competition lost by the merger. Based on the evidence before it, the OFT could not conclude that this was the case. Neither was the OFT persuaded that countervailing buyer power would be sufficient to prevent the adverse unilateral effect identified.

169. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom that is: the supply of freight ferry services on the diagonal routes between Great Britain and Northern Ireland.

DECISION

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

Amelia Fletcher
Chief Economist
Office of Fair Trading
8 February 2011

END NOTES

1. With regard to paragraph 1, the OFT clarifies that Stena is ultimately controlled by the Sten A. Olsson family.

2. With regard to footnote 49 to paragraph 62, Stena clarified that the Stena Line executive board is the most senior 'executive' board of Stena Line's ferry business and is distinct from the Stena Line Holding BV's non-executive board.