

Completed acquisitions by Stagecoach Group plc of Eastbourne Buses Limited, and Cavendish Motor Services

ME/4030/09 / ME/4031/09

The OFT's decision on reference under section 22(1) given on 13 May 2009. Full text of decision published on 2 June 2009.

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

PARTIES

- 1. Stagecoach Group PLC** (Stagecoach) is a wholly-owned subsidiary of the Stagecoach Group, an international public transportation group, with operations in the UK, USA and Canada. Prior to the two transactions under consideration (the Transactions), Stagecoach's wholly-owned subsidiary, Stagecoach in East Kent & Hastings, employed about 1,000 people and ran a fleet of about 330 buses from six depots across East Kent and Hastings. While it did not operate local bus services in Eastbourne, it operated two inter-urban services (Services 98 and 99) between Eastbourne and Hastings.
- 2. Eastbourne Buses Limited** (Eastbourne Buses) provided local bus services in the town of Eastbourne, the neighbouring town of Hailsham, and East Grinstead. Eastbourne Buses was majority (80 per cent) owned by Eastbourne Council and 20 per cent owned by Keolis, a French transport company. Eastbourne Buses' turnover for the year ending 31 December 2008 was £5.6 million.
- 3. Cavendish Motor Services** (Cavendish) provided local bus services in the town of Eastbourne and neighbouring town of Hailsham. Cavendish was a wholly-owned subsidiary of Renown Coaches Limited (Renown), a bus operator based in Bexhill, East Sussex. Cavendish's turnover for the year

ending 31 July 2008 was £620,000.¹

TRANSACTION

4. On 18 December 2008, Stagecoach acquired the entire share capital of Eastbourne Buses. Eastbourne Buses' assets included 50 buses, 152 employees and a depot in Eastbourne with capacity for 100 buses.
5. On 2 October 2008, Stagecoach signed a share purchase agreement for the entire share capital of Cavendish. The acquisition was completed on 5 January 2009. Cavendish's assets consisted of 28 buses and 65 employees. Renown's bus depot located in Bexhill was not included in the transaction.

JURISDICTION

6. As a result of the Transactions, Stagecoach has ceased to be distinct from Eastbourne Buses and has ceased to be distinct from Cavendish.
7. Section 23(9) of the Enterprise Act 2002 (the Act) states that the question whether a relevant merger situation has been created shall be determined immediately before the time when the reference has been, or is to be, made. As a result of the operation of this section, Stagecoach is to be treated as overlapping with both Eastbourne and Cavendish in the supply of bus services in Eastbourne and Hailsham² for jurisdictional purposes.³
8. Stagecoach has questioned whether Eastbourne should be treated as constituting a 'substantial part of the UK' for the purposes of the share of supply test under section 23(4) of the Act. It contends that the population

¹ However, this figure is not representative of Cavendish's actual turnover at the time of its acquisition. In the five months between August 2008 and January 2009, Cavendish's turnover was approximately £614,000, which equates to an annual turnover of approximately £1.47 million.

² Although these are two distinct towns, for ease of reference they are referred to, collectively, as 'Eastbourne' hereafter.

³ that is, at the time of the decision on reference, Stagecoach already owned Eastbourne Buses (for the purpose of the Cavendish acquisition) and already owned Cavendish (for the purpose of the Eastbourne Buses acquisition). In any event, as noted earlier, at the time of the Eastbourne Buses transaction (which was the first acquisition completed by Stagecoach) Stagecoach itself already operated two inter-urban services between Eastbourne and Hastings, so Stagecoach and Eastbourne Buses overlapped in the supply of bus services in Eastbourne. Given Eastbourne Buses alone had a share of supply of over 25 per cent of local bus services in Eastbourne, the combined Stagecoach/Eastbourne Buses entity is also greater than 25 per cent and the share of supply test is therefore met on this basis even disregarding the operation of section 23(9) of the Act.

of Eastbourne is approximately 95,000 (much less than one per cent of the UK) and has only a small geographic area (44.2 square kilometres). Further, it argues that it is doubtful that Eastbourne is of such geographic or financial importance as to make it a 'substantial part of the UK', given that its primary income is derived from tourism. Finally, Stagecoach argues that the Eastbourne local bus market cannot be considered economically important, being valued at only £6.22 million. Stagecoach thus questioned whether the OFT was acting reasonably in asserting jurisdiction under the share of supply test in this case.

9. While there is no statutory definition of what constitutes a 'substantial part of the UK', the House of Lords in *Regina v Monopolies and Mergers Commission and another; ex parte South Yorkshire Transport Limited ('ex parte South Yorkshire')*,⁴ involving the merger of two local bus companies in South Yorkshire, considered that this definition required that an area or areas must be considered of such size, character and importance as to make it worth consideration for the purposes of merger control. In that case, Lord Mustill stated that:

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

10. The OFT has taken proper account of this comment in determining its approach to the application of the 'substantiality' criterion under section 23(4) of the Act. Despite its comparatively small population and geographic area, Eastbourne appears to have a vibrant tourism economy, receiving approximately four million visitors each year.⁵ The OFT notes that while the population of Eastbourne alone is approximately 95,000, Hailsham's

⁴ [1993] 1 ALL ER 289

⁵ <http://www.visiteastbourne.com/about.asp#>

population is likely to be at least 19,000,⁶ making the combined area nearly as large as Slough (approximately 120,000), which the CC found to constitute a substantial part of the UK in its report on Tesco/Co-Op Slough.⁷

11. In light of the above factors, in particular of Lord Mustill's comments in *ex parte South Yorkshire* above, and taking account of the fact that the OFT is required to decide on the existence of a relevant merger situation on an 'is or may be the case' standard, the OFT considers it reasonable to consider that Eastbourne is a substantial part of the UK for the purposes of UK merger control.⁸
12. For each transaction, the combined share of supply share significantly exceeds 25 per cent in relation to the supply of bus services in Eastbourne, and the share of supply test in section 23 of the Act is therefore met. As such, the OFT believes that in relation to each transaction it is or may be the case that a relevant merger situation has been created. In any event, the OFT notes that the share of supply test would also likely be met on the basis of the wider geographic area of Eastbourne and Hastings.

MARKET DEFINITION

13. Eastbourne Buses and Cavendish overlap in the supply of local bus services. In previous cases the OFT and the CC have tended to focus on the competitive effects of the merger rather than specifically defining the appropriate relevant market. In practice this has meant considering the competitive constraints on different transport modes on a flow-by-flow basis (and where relevant, an analysis of network effects, if any) in order to determine whether the merger may provide an incentive to increase fares or reduce service levels. In order to focus attention on those flows most likely to raise concerns, the CC has developed a number of 'filters' to identify flows on which the merged entity is unlikely to have either the incentive or ability to exercise market power post-merger.⁹ These filters are

⁶ See <http://www.eastsussex.com/towninfo/hailsham.php>;
http://www.wealden.gov.uk/Planning_and_Building_Control/Local_Plan/Adopted_Local_Plan/Chapter14.pdf

⁷ 28 November 2007.

⁸ In any event, the OFT notes that the share of supply test would also likely be met on the basis of the wider geographic area of Eastbourne and Hastings.

⁹ Competition Commission *Review of Methodologies in Transport Inquiries* (2006). In practice, flows are excluded where a flow comprises less than ten per cent of the total revenue of a route

not safe harbours, however, and the OFT is not bound to apply them in every case. Especially on flows where a transaction results in only one operator on a given flow, as in the present case, further analysis may be required.

14. In the present case, however, the OFT did not consider it necessary to perform an in-depth flow-by-flow analysis in order to assess the competitive effects of the mergers, and therefore did not apply the CC's filtering methodology. The reasons for this are as follows: first, Eastbourne Buses and Cavendish were the only suppliers of commercial local bus services in Eastbourne, with Eastbourne Buses operating 13 routes and Cavendish operating eight. The mergers therefore resulted in a merger to monopoly on all but three overlap flows – 67 in total.¹⁰ Second, the OFT believes that competition between Eastbourne Buses and Cavendish occurred on a network-wide basis within the town of Eastbourne rather than on a flow-by-flow basis. Even though competition may occur on flows, pricing and frequencies are often set at a wider level.¹¹ Each of Eastbourne Buses' and Cavendish's routes overlapped with the other's in a complex network. As a result, it is likely that prices and frequencies were set with these complex network-wide overlaps in mind.¹²
15. In practical terms, the OFT notes additionally that, given the large number of overlapping flows and apparent lack of competition from other sources (discussed below), similar issues were likely to arise on virtually all overlap flows, such that assessing the merger on a network-wide basis was a more pragmatic and efficient starting-point in the context of a Phase I merger investigation.

Tendered services

16. Tendered services tend to be for a fixed duration and contain set parameters such as price and quality levels. Operators compete with each

and where the frequency of overlapping services is less than half as frequent as the main service (for example, one is every ten minutes and one is half hourly)

¹⁰ Stagecoach submitted, and the OFT's market enquiries confirmed, that tendered and inter-urban services do not constrain intra-urban commercial services. In addition, there are rail overlaps on three flows which are discussed below.

¹¹ For example, both Eastbourne Buses and Cavendish had uniform ticket prices for all journeys within Eastbourne, as well as for journeys to surrounding areas, such as Hailsham.

¹² Eastbourne priced single tickets across its network at £1.80 for children and at £2.70 for adults; Cavendish at £1.60 for children and £2.50 for adults.

other to provide these services under contract from councils, with the lowest bid usually winning the tender. Tendering tends to occur for routes that would be loss-making for a commercial operator, so the overlap between them and commercial routes is often minimal.

17. The OFT's market enquiries indicated that there were relatively few tendered services in Eastbourne and that they did not constrain commercial services. Unlike the situation for commercial services, the OFT identified at least five other operators of tendered services in Eastbourne besides the parties, some of which had a record of winning tenders from Stagecoach. In light of the above, and given the fact that no concerns were raised in relation to tendered services in Eastbourne, the OFT considers competition concerns are unlikely to arise with respect to tendered services and these are not discussed further.

Inter-urban services

18. Pre-merger, both Stagecoach and Eastbourne Buses provided inter-urban services to and from Eastbourne, although they did not service the same destinations: Stagecoach's 98 and 99 services went between Eastbourne and Hastings, while Eastbourne Buses' 52 and 54 services went to Tunbridge Wells and East Grinstead respectively. Cavendish did not operate any inter-urban services.
19. Market enquiries indicated that inter-urban services are unlikely to be a constraint on intra-urban commercial services in Eastbourne. Only one third-party inter-urban service, run by Brighton & Hove,¹³ was identified in Eastbourne; however this service did not compete with any Cavendish or Eastbourne Buses services. In light of the above, and given no competition concerns were raised, the OFT considers competition concerns do not arise and inter-urban services are therefore not discussed further.

Rail

20. Stagecoach submits that there is rail competition on three overlaps:
 - Polgate – Eastbourne
 - Eastbourne – Hampden Park, and

¹³ Part of the Go Ahead Group.

- Eastbourne – Pevensey Bay.
21. Given that rail travel only overlaps with the parties' commercial bus services on only three out of 70 overlapping flows, the OFT considers it improbable that rail would be a significant constraint on pricing and service provision across the network as a whole. It therefore does not consider these overlaps in more detail.

Other forms of transport

22. Finally, Stagecoach submitted that the merged firm is likely to face competition on all routes and flows from cycling, walking, taxis and private cars. It submitted that, given the relatively short nature of point-to-point journeys in Eastbourne, cycling or walking is a realistic alternative to bus travel. With respect to private cars and taxis, Stagecoach has submitted that taxi fares for certain journeys in Eastbourne are comparable to bus fares if the taxi is shared between three people.¹⁴
23. In past merger inquiries, the OFT and CC have concluded that there was limited substitution between public and private transport in response to changes in relative prices. Similarly, in this case, the OFT did not receive any substantiated evidence that taxis, private cars, walking or cycling would be likely to provide a constraint on bus pricing in Eastbourne. Market enquiries also suggested that these other forms of transport did not constrain commercial bus services in Eastbourne.

Conclusion

24. In this case, the OFT does not consider that other forms of transport, including other types of bus and coach services, would be likely to constrain the merged entity's commercial local bus operations in Eastbourne.

COMPETITIVE ASSESSMENT

The Counterfactual

Introduction

25. Stagecoach made two different arguments in relation to the appropriate

counterfactual against which the merger should be assessed. The first, more conceptual, argument related to how the counterfactual should be applied to each transaction given the sequencing of the two transactions. The second, more empirical, argument related to the scope for competition between two bus operators in Eastbourne. Each argument is addressed below.

The counterfactual analysis applicable to each transaction

26. Stagecoach argued that the appropriate counterfactual for each merger ought to be assessed at the time of completion of the relevant transaction, and therefore should be:
 - for the Eastbourne Buses acquisition – Stagecoach not operating any intra-urban commercial bus services in Eastbourne, and
 - for the Cavendish acquisition – Stagecoach owning Eastbourne Buses.
27. The OFT accepts Stagecoach’s argument that the relevant question in relation to the counterfactual is what would have happened in the absence of the merger – and therefore that the appropriate point in time at which the counterfactual should be considered – is at the time of the relevant transaction. However, the OFT does not accept that it is required to ignore for the counterfactual analysis any other events that would have happened absent the merger simply because they actually take place after the completion of the merger (that is, including events that actually have happened at the date of the decision on reference that were not dependent on the merger itself). It is for this reason that the OFT will take account, in its competitive assessment, of events that have happened since the merger where it cannot be confident that they would not have occurred absent the merger itself (that is, such that they should not be considered part of the counterfactual).¹⁵
28. The OFT’s task as a Phase I merger regulatory body is ultimately to determine whether there is a realistic prospect that a given merger will result in a substantial lessening of competition. In doing this, it will generally assess the merger in light of the most conservative, but realistic, counterfactual (which will typically, but not inevitably, be prevailing

¹⁴ Stagecoach identified 15 flows where it argued taxis could be a constraint.

¹⁵ See the OFT’s analysis in *Celsa Steel Service (UK) Limited / BRC Limited / Express Reinforcements Limited / The ROM Group* (2009).

conditions of competition pre-merger). In taking this approach, the OFT considers that, if a given merger can be cleared on the most conservative counterfactual, then it is not necessary to test it against the alternatives (for example, that a parallel transaction in the market is subsequently unwound).

29. In this case, it was not clear to the OFT in respect of either transaction that it would only have gone ahead if the other transaction also did so. The two transactions were separate and not contractually inter-conditional. At the time Stagecoach contractually agreed to acquire Cavendish, it remained uncertain whether it would acquire Eastbourne Buses because the outcome of the tender process for Eastbourne Buses was still unknown. Nevertheless, the OFT was informed that Stagecoach sought originally to acquire Eastbourne before it knew that Cavendish would be available to purchase. For these reasons, a realistic counterfactual for both transactions is that Stagecoach would have owned one bus business whilst the other bus business was either not sold at all (particularly applicable in relation to the Cavendish business) or was sold to another third party bidder (particularly applicable in relation to the Eastbourne Buses business).
30. In both cases, the relevant question for the OFT was whether the addition of the relevant target business itself created a realistic prospect of a substantial lessening of competition. In determining the answer to this question for both relevant merger situations, the OFT assessed the competitive constraints that the merged entity would be likely to face following the mergers (as it would do in assessing an individual merger).
31. Finally, the OFT notes that, even if Stagecoach's suggested approach were taken, and the transactions were considered sequentially, this would not make a material difference to the OFT's substantive analysis. In both the OFT's approach and Stagecoach's suggested approach, the Cavendish transaction is to be assessed against a backdrop of Stagecoach owning Eastbourne Buses (such that the substantive overlap between Eastbourne Buses and Cavendish is considered in any event).

The scope for competition between two bus operators in Eastbourne

32. Paragraph 3.24 of the OFT's Substantive Assessment Guidance¹⁶ states:

¹⁶ Mergers Substantive Assessment Guidance (OFT 506).

'In most cases, the best guide to the appropriate counterfactual will be prevailing conditions of competition. However, the OFT may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger.'

33. Stagecoach argued that, with or without the acquisitions, it was inevitable that Eastbourne would have ended up with one commercial bus operator. It contended that whoever bought Eastbourne Buses would invariably have sought to acquire Cavendish and, failing such an acquisition, that Cavendish would have exited the market. In circumstances where a large, efficient operator runs commercial services in Eastbourne, Stagecoach argues that there is unlikely to be room for another operator.
34. The OFT requires strong and compelling evidence in any situation in which parties argue that a substantial lessening of competition is caused by the inevitability of exit of one of the merging parties rather than the merger itself. This evidentiary standard is required in relation to 'failing firm' cases¹⁷ and is applicable also in cases where parties claim that competition that existed pre-merger would not in any event have been 'sustainable' going forward such that one party would have exited the market.
35. On the basis of the evidence before it, the OFT does not consider that it can confidently conclude that only one operator would have remained in Eastbourne absent the mergers, for the following reasons.
36. First, Stagecoach itself accepted that competition between the target companies prior to March 2008, when Cavendish started to increase significantly the frequency of its services, was sustainable. The OFT has not received any evidence to suggest that, post-merger, were Cavendish's services to return to pre-March 2008 levels, competition would not have again been 'sustainable'. Stagecoach's comment that the purchase price for Cavendish reflected the fact that there were 'good parts' to the business appears consistent with this.
37. Second, it is not clear why Stagecoach would have been prepared to acquire Cavendish if it was genuinely inevitable that Cavendish would have exited the market upon an acquisition of Eastbourne Buses by a major

¹⁷ OFT *Restatement of Position on Failing Firms*, December 2008.

operator. Stagecoach's internal valuation documents suggest that Stagecoach itself contemplated the possibility that Cavendish would remain in the market, at least in the short term. It appears that Stagecoach anticipated not only achieving synergies from acquiring Eastbourne Buses, but also benefitting from the loss of competition from Cavendish. The ownership of the 'main competitor' to Cavendish appears to have been a factor in Stagecoach putting in a revised, increased bid for Eastbourne Buses.

38. With respect to the Cavendish acquisition, Stagecoach advised that the approximate breakdown of Cavendish deal was approximately £[] for the buses and £[] in goodwill. Stagecoach advised that it saw value in the 'good parts' of Cavendish and this was reflected in the purchase price. Finally, Stagecoach advised that competing Cavendish out of the market would have imposed costs on Stagecoach, which could be avoided by purchasing Cavendish instead.
39. However, the OFT believes it credible that Stagecoach's rationale in buying both companies was that it believed Cavendish was viable and would continue to operate as a competitor, at least in the short-term.
40. Third, Renown has advised the OFT that, had it not been acquired by Stagecoach or another operator, Cavendish would probably have continued to operate in Eastbourne, at least in the short term, although it may have had to reduce its services.ⁱ
41. Fourth, the OFT notes that there were rival bidders for both the Eastbourne Buses and Cavendish businesses. Indeed, the OFT understands that negotiations between Cavendish and one national operator had at one time reached the point where an exclusivity period was entered into, giving the operator the sole right to purchase during that period. Thus, the OFT considers it plausible that, in the event Stagecoach did not acquire Cavendish, another company may have acquired it. Similarly, in the event that Stagecoach did not acquire Eastbourne Buses, the OFT cannot rule out the possibility that another company may have acquired it and competed head-to-head with a Stagecoach-owned Cavendish.¹⁸

42. For all the above reasons, the OFT cannot confidently conclude that absent the acquisitions by Stagecoach there would inevitably have been only one bus operator in Eastbourne. The OFT therefore considers it appropriate to assess the merger on the basis of the pre-merger competition that existed between Eastbourne Buses and Cavendish, whilst taking any necessary account of the comments from Cavendish that it might have been required to scale down its services going forward.

Conclusion

43. In light of the above, for each transaction the OFT tested the merger by reference to the below counterfactuals:
- for the acquisition of Eastbourne Buses – Stagecoach owning Cavendish, and
 - for the acquisition of Cavendish – Stagecoach owning Eastbourne Buses.

Horizontal Issues

44. As a result of the acquisitions, Stagecoach is the monopoly provider of commercial local services in Eastbourne.

Actual competition

45. Eastbourne Buses' and Cavendish's networks overlapped extensively pre-merger: Eastbourne Buses operated 13 routes, while Cavendish operated eight. As noted, these routes overlapped on 70 different flows across Eastbourne. On the vast majority of flows Eastbourne Buses and Cavendish ran on similar frequencies and prices¹⁹ (although Cavendish's services tended to be slightly lower frequency). In addition there are specific examples of the companies responding to fare and service changes by the other. For example, a former senior Eastbourne Buses employee advised that, in late 2006 it lowered the price of its weekly ticket from £15 to £12 and introduced a 'family' ticket in response to competition from Cavendish. Further, on at least one occasion it altered a service to strengthen its

¹⁸ Although Stagecoach did not own a depot in Eastbourne, it may have been able to continue running Cavendish, for example, by using the same rented parking space in Polegate and Renown's maintenance facilities in Bexhill.

¹⁹ This was the case even prior to Cavendish increasing the frequency on a number of its services in July 2008.

position in an area where it felt vulnerable to future competition from Cavendish.²⁰

46. Between July 2008 and December 2008, competition between Eastbourne Buses and Cavendish was fierce, with Cavendish increasing frequencies on many of its routes in an attempt to win market share from Eastbourne. During this time, however, both Eastbourne Buses and Cavendish sustained losses and Stagecoach contends that this period of competition was 'unsustainable'. Stagecoach further contends that the merger should be assessed with reference to the 'sustainable' period of competition. Nevertheless, although the OFT accepts that, absent the merger (and to the extent that it were not acquired by a different third party bus operator), Cavendish may have reduced its services to some degree, it is not possible to determine to what extent this would have been required. Further, based on Cavendish's operations prior to July 2008, such retrenchment by Cavendish would have been likely to impact mainly on the frequency of its services, rather than the number of routes it operated.
47. The evidence before the OFT therefore indicates that the target companies competed on both price and service quality. As a result of the merger, this competition between Eastbourne Buses and Cavendish has been lost.

Potential competition

48. Given that actual competition between the target companies' services accounted for the majority of the value, by revenue, of the commercial intra-urban bus market in Eastbourne, the OFT did not consider it necessary to consider in detail the effect, if any, on potential competition (that is, the removal of a potential entrant onto a flow where only one of the target companies operated) that the mergers may have had.

Conclusion

49. In light of the above, the OFT considers that the mergers would eliminate the actual competition between Eastbourne Buses and Cavendish.

Barriers to entry and expansion

50. Market enquiries revealed that a new operator wishing to run commercial bus services in Eastbourne would be likely to require the following:

²⁰ By extending the number 1 route into Hampden Park.

- a. buses and drivers
- b. a depot or a place to park its buses
- c. access to back office functions such as IT, administration, payroll, maintenance etc, and
- d. the appropriate licences from the Traffic Commissioner.

Buses, drivers and licences

51. With regards to c and d, above, in previous cases the OFT has found that these usually do not constitute a barrier to entry or expansion and market enquiries confirmed this is likely to be the case in Eastbourne.

Depots, maintenance and back of house functions

52. Regarding access to a depot, Stagecoach contends this is not a barrier to entry. Although it conceded that there are no existing depots in Eastbourne, it argued that it is not necessary to own a depot in Eastbourne. Stagecoach argued that entry is possible by renting parking space in Eastbourne (of which Stagecoach claims there is an ample supply) to house buses. It also argued that maintenance can be provided by any number of commercial garages in the area, buses can be re-fuelled at service stations and back office functions can be conducted from rented office space virtually anywhere.
53. In support of this contention, Stagecoach submitted that Cavendish entered in 2006 using a portakabin in a shared parking space to house its buses. Cavendish's buses were serviced at Renown's Bexhill depot about once a month, and it shared back office and refuelling facilities with Renown as well. Stagecoach argued that there are a number of bus companies operating contiguous bus networks that could enter the Eastbourne market with relative ease using the same or similar entry model to Cavendish were they inclined to do so.
54. In terms of existing bus or coach companies utilising a similar entry model, however, the OFT was unable to identify any bus companies, other than Renown, in the immediate area with a depot, as well as maintenance and administration functions, with a proximity to Eastbourne that would allow it

to replicate Cavendish's entry strategy. Further, market enquiries revealed that utilising a commercial garage to carry out regular, routine work was likely to be unviable due to the relatively high cost compared to performing these functions in-house. Further, given any new entrant would be competing against a well-resourced national operator (and one that is not constrained in its ability to respond to competition, such as Eastbourne Buses was), the OFT considers that the minimum requirements for viable, sustained entry are likely to have been increased by the merger, such that entry on a Cavendish-type scale may no longer be viable.

55. In addition to obtaining the above physical assets and licences, market enquiries also indicated that other, non-tangible, barriers to entry in the form of scale of entry and/or sunk costs associated with entry may also operate in the market.

Scale of entry required

56. Cavendish entered the market in 2006 with four buses operating a single route and progressively built up its business. This, according to Stagecoach, suggests that entry is possible on a route-by-route basis. Nevertheless, the OFT notes that Cavendish's entry was at a time when the incumbent, Eastbourne Buses, was in financial difficulties and was limited in its ability to retaliate. Further, anecdotal evidence received from market participants suggests that Eastbourne Buses initially did not take Cavendish seriously and did not expect it to survive. The OFT considers it unlikely that entry against Stagecoach would fail to elicit a competitive response, and Stagecoach itself is aware of its reputation in the industry for responding aggressivelyⁱⁱ to new entry. Indeed, a number of market participants indicated that they would not be prepared to enter at all into an area where Stagecoach was the incumbent for this reason.
57. The OFT notes that, to the extent that the valuation for the business reflects the removal of a competitor (as discussed above), this may also suggest that Stagecoach considered entry prospects as limited.

Expansion by existing operators

58. In light of the above consideration of barriers to entry, the OFT considered whether, in the event of a market-wide SSNIP²¹ or decrease in service standards or frequencies, expansion by existing operators would be sufficiently timely, likely and effective to constrain the merged entity.
59. Stagecoach provided examples of a number of potential entrants operating bus or coach services in the areas surrounding Eastbourne. However, in line with the above discussion on barriers to entry, the OFT was not satisfied that entry by any of them would be timely, likely or sufficient. First, a number of operators indicated that their depots were too far away from Eastbourne to make entry viable. These operators indicated that the number of 'dead miles' involved in servicing Eastbourne would mean their costs would be above acceptable levels. Further, no operators surveyed stated they would consider entry on a 'Cavendish-like' basis. Finally, some operators stated that it would not be viable to enter against Stagecoach, regardless of price increases or quality decreases, as they anticipated a competitive response from Stagecoach.
60. Renown, the most likely potential entrant having previously set up Cavendish, also stated that it would not enter against SC in the event of a SSNIP. It stated that it would, however, consider entry were a situation similar to that when Cavendish entered the market to occur again. Renown considered that Eastbourne Buses' service quality had been very low and that there were gaps in its service where an entrant could operate profitable routes. It was also aware that Eastbourne Buses had been in financial difficulties and not likely to be able to respond to entry. It did not believe that a situation similar to this would occur in the future as Stagecoach's network in Eastbourne did not have any obvious gaps in its service and because Stagecoach would be able to respond more aggressively to entry.
61. Therefore, even putting to one side the fact that Renown is prohibited by a non-compete obligation from competing with Stagecoach for two years following the acquisition of Cavendish, the OFT did not consider entry from Renown to be timely, likely and sufficient in the event of a small but significant increase in price or decrease in frequency or service quality.

THIRD PARTY VIEWS

²¹ Small but significant non-transitory increase in price.

62. None of the third parties who were contacted by the OFT during the course of its investigation raised any competition concerns about the transactions, nor were any concerns expressed by customers. Eastbourne Council, the previous majority owner of Eastbourne Buses, was reluctant to express any view on the potential impact on competition of the merger.

ASSESSMENT

63. Routes operated by Eastbourne Buses and Cavendish in Eastbourne overlapped extensively on 70 flows pre-merger. As a result of the acquisitions, Stagecoach is a monopoly provider of commercial local bus services in Eastbourne. Rail services may be a constraint on up to three flows but the OFT did not conclude on this point.
64. Absent the transactions, the OFT considers that it is at least realistic that two different bus operators would have continued to operate and compete against each other in Eastbourne, albeit that it is far from clear that those operators would have continued to be Eastbourne Buses and Cavendish. The transactions are regarded as having foreclosed this possibility.
65. The main barrier to entry to supplying commercial bus services is local depot capacity. Although Cavendish entered in 2006 using a portakabin and a depot 12 miles away it used every month or so for maintenance, the OFT was unable to identify any other company with a proximate depot from which to enter. Commercial garages were not considered a cost-effective alternative for maintaining buses. In any event, no potential entrant indicated it would be willing to enter in the event of a SSNIP or a decrease in quality. Notably, the most likely entrant, Cavendish's former owner, Renown, stated it would not enter under these conditions, although it may if an Eastbourne-like situation came up again. In any case, Renown was barred from entering by a two year non-compete clause.
66. Consequently, the OFT believes that it is or may be the case that each merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

EXCEPTIONS TO THE DUTY TO REFER

Introduction

67. The OFT's duty to refer under section 22(1) is subject to the application of certain discretionary exceptions, including the markets of insufficient importance, or 'de minimis', exception under section 22(2)(a), the customer benefits exception under section 22(2)(b) and the undertakings in lieu exception under section 73(2) of the Act. Each of these is considered in turn below.

'De minimis' exception

68. The parties argued that the OFT should apply the 'de minimis' exception to the duty to refer²² on the basis that the value of the market concerned in the UK was significantly less than £10 million per annum.

Undertakings in lieu of reference and 'de minimis'

69. For the reasons explained in full in the OFT's Dunfermline Press/Trinity Mirror decision,²³ the OFT believes that it would be proportionate to refer a problematic merger (that is, not to apply the 'de minimis' exception) where the OFT considers that it is 'in principle' clearly open to the party (or parties) to offer a clear-cut undertaking in lieu of reference – but they have in fact chosen not to do so – because the recurring benefits of avoiding consumer harm by means of undertakings in lieu in a given case, and all future like cases, outweighs the one-off costs of a reference.

70. The OFT did not consider, based on its objective evaluation of the transactions, that this case was a clear candidate for resolution by means of undertakings in lieu. Effectively, a structural divestment of either the Cavendish or Eastbourne business would unwind one of the transactions by removing the entire overlap created by the merger. Given that the OFT does not include what would amount to prohibition when considering whether clear-cut undertakings in lieu are in principle available, the OFT therefore considers that it would not be appropriate to rule out the application of the 'de minimis' exception at this stage of the analysis.

²² See OFT 516 b, November 2007.

²³ OFT Decision *Completed acquisition by Dunfermline Press Limited of the Berkshire regional newspapers business from Trinity Mirror plc* 4 February 2008.

Application of the markets of insufficient importance exception to this case

71. The factors that the OFT considers in determining whether it should apply its discretion in respect of the *'de minimis'* exception have been set out in detail in a number of previous cases.²⁴ The relevant factors are:
- the size of the market(s) concerned
 - the strength of the OFT's concern (that is, its judgment as to the probability of the substantial lessening of competition occurring)
 - the magnitude of competition lost by the merger
 - the durability of the merger's impact, and
 - the transaction rationale and the value of deterrence.
72. The OFT has considered each of the above factors in determining whether to exercise its discretion in this case.
73. **Market size** – Based on the most recent figures available to the OFT,²⁵ the aggregate turnover of Cavendish and Eastbourne Buses was £6.22 million, which approximates to the size of the market concerned. A high proportion of routes, and therefore of this figure, is affected by the merger. The OFT accepts that it may be appropriate to remove from the affected market size the turnover on the routes on which there is competition from rail services (amounting to approximately £100,000), although it did not need to conclude on this point.
74. Stagecoach additionally argued that a small proportion of the market turnover figure (totalling approximately £35,000) should be removed for these purposes to reflect the existence of a number of non-overlapping and partially tendered flows.²⁶ The OFT did not need to conclude on this point, however, given it makes no difference to the substantive analysis in this case.

²⁴ See for example OFT Decision *Anticipated acquisition By BOC Limited of the Packaged Chlorine Business and Assets carried on by Ineos Chlor Limited* 29 May 2008 and, most recently, OFT Decision *Completed acquisition by Capita Group plc of IBS OpenSystems plc* 19 November 2008.

²⁵ Eastbourne Buses' annual turnover figures for the year ending 31 December 2008 and Cavendish's annual turnover figures for the year ending 31 July 2008.

²⁶ The OFT notes that the impact of any price rise on overlap flows would also be felt across the entire route, as pricing is set on a network basis. As such, it may not be appropriate to deduct the turnover associated with non-overlap flows.

75. Stagecoach further argued that turnover should be deducted to reflect Cavendish's uplifted frequency of service from July 2008 which Stagecoach argued to be unsustainable. The OFT would note, however, that, since the calculation of aggregate turnover is based on Cavendish's turnover for the year ending 31 July 2008, most of the uplifted frequency is not included. Further, it would be appropriate to adjust for corresponding changes in Eastbourne Buses' turnover during this period. In order to calculate the aggregate turnover to exclude the period of ramped up competition post-July 2008, the OFT has therefore totalled the parties' turnover for the year ending 31 June 2008. Allowing for this, Cavendish's turnover is £560,000 and Eastbourne Buses' turnover is £5.78 million, and therefore the combined turnover of the parties is £6.34m.
76. Most significantly, in terms of valuing the market, the OFT does not accept Stagecoach's contention that the value of the market should be reduced by 45 per cent to remove concessionary travel from the market. Even if there were no price competition on these routes, the parties still compete on quality and frequency of services on these routes, including for the patronage of concessionary fare passengers. As a result, even accepting all of Stagecoach's arguments for deductions (except concessionary fares, which the OFT considers inappropriate) the OFT considers that the annual value of the market concerned for the purposes of the de minimis assessment is likely to be in the region of £6 million. The OFT has not previously applied the de minimis exception in markets of this size and notes it will be unlikely to do so unless its assessment of the other relevant factors strongly suggest it should do so.
77. **Strength of the OFT's concerns** – As judged against pre-merger conditions, the OFT's belief that the transactions may be expected to result in a substantial lessening of competition would be on the balance of probabilities (that is, over 50 per cent likely, or at the 'is the case' standard in the wording of section 22 of the Act). This reflects the likelihood of the loss of all competition on direct overlap routes, accounting for a large part of the network, and the fact that there is no countervailing factor to remove or reduce the impact of the merger. However, the OFT accepts that there are a range of plausible counterfactuals against which these acquisitions could be assessed. While the OFT has found there to be a realistic prospect that two operators would have remained in Eastbourne absent the transactions, it is not inevitable that this would be the case.

Therefore, overall, the strength of the OFT's concerns in this case are of a 'may be the case' standard.

78. **Magnitude of competition lost by the merger** – although Cavendish's size, measured by turnover, is small, the merger will result in a merger to monopoly on a large part of the overall market. Such consolidation would normally be indicative of a large degree of competition lost by the merger and therefore significant likely consumer harm. Further, Cavendish had, increased its frequencies prior to the merger, suggesting it was a vigorous and effective competitor in the market. Overall, the magnitude of competition lost by the merger is expected to be reasonably significant.
79. **Durability of the merger's impact** – the OFT is not aware of any reasons why the duration of the substantial lessening of competition would be expected to be limited in duration such as to limit the temporal significance of the loss of competition. In particular, it does not consider that future entry is likely to be a constraining factor on the merged entity in this case.
80. **Transaction rationale and value of deterrence** – the OFT considers that the deterrence factor in relation to this case should be considered to be no less than average given the fact that Stagecoach is through these transactions purchasing each of Eastbourne Buses' and Cavendish's only other competitor in Eastbourne, leaving Stagecoach with a monopoly. Although it is certainly not inevitable that Eastbourne would have retained two separate bus operators absent Stagecoach's acquisition, there was at least a realistic prospect of this under a number of different counterfactual possibilities. The OFT notes in addition that, although the position is not wholly clear such that excessive reliance should not be placed on this point, there are several internal documents from Stagecoach that appear to contemplate the benefits of a loss of competition arising from the transactions in its pre-merger planning.

Conclusion on 'de minimis' exception

81. Overall, the OFT considers that the evidence points towards the impact of the merger being significant. In particular, the £6 million size of the market and the fact that there would be a significant deterrent effect expected in relation to a merger to monopoly collectively mean that the OFT's judgement is that this is not a case that is suitable for application of the 'de minimis' exception. Indeed, the OFT notes for completeness that none of

the various factors considered by the OFT as detailed above point strongly towards the exercise of the discretion in this case.

Customer benefits exception

82. Under section 22(2)(b) of the Act, the OFT may decide not to make a reference where it believes that any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition concerned and any adverse effects of the substantial lessening of competition concerned.
83. Situations where customer benefits might be weighed against an identified loss of competition are defined in section 30 of the Act as being when the merger results in lower prices, higher quality, greater choice or greater innovation (although in this context such benefits need not be in the same market as that, or those, in which the substantial lessening of competition has occurred or will occur). For the OFT to exercise its discretion not to refer a merger on this basis, the claimed customer benefits must be clear, timely, and merger-specific.
84. Stagecoach argued that the merger would result in a number of customer benefits as a result of having a single bus operator in Eastbourne. In particular, they claimed such benefits in the form of improved services across a coherent and integrated network, with the frequency and range of connecting services being enhanced, as well as the introduction of Eastbourne network tickets being available on all routes.
85. Stagecoach has submitted evidence which suggests overall a marginal improvement in bus frequencies when compared to March 2008, when it argues that competition between Cavendish and Eastbourne Buses was sustainable. The OFT notes, however, that on some routes there has been a reduction in bus frequencies and that on half of the routes there has been no change. (To the extent that this was to be compared to the situation in December 2008, when Stagecoach argues competition was unsustainable, there would be a clear reduction in bus frequencies on the majority of routes.)
86. The OFT is sympathetic to the view that this merger might indeed lead to some customer benefits, but it has been provided with insufficient evidence that these benefits are clear, timely and merger specific and that they

outweigh the expected substantial lessening of competition and the adverse effects of the substantial lessening of competition.

UNDERTAKINGS IN LIEU

87. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted, or may result, from it.
88. In this case, the parties offered two forms of undertakings in lieu of reference. First, they offered to release or waive Renown from the non-compete clause that it had entered into on the sale of Cavendish to Stagecoach. Second, they offered to hold pricing in Eastbourne constant for a period of three years by committing not to increase prices above standard rises in East Sussex and Kent.
89. While the OFT welcomes the willingness of the parties to put forward remedies, it does not consider that the remedies proposed in this case are capable of sufficiently removing the competition concerns arising from the merger.
90. In relation to the offer to waive Renown's non-compete provision, the OFT does not believe (as already noted above) that Renown should, going forward, be considered a timely, likely and sufficient entrant such as to remove competition concerns. Entry by Cavendish in 2006 against an ineffective and poorly managed Eastbourne Buses is not evidence that Renown would enter going forward against Stagecoach, in particular given Stagecoach's reputation for retaliation against other entrants.²⁷ Finally, Renown itself cast serious doubt over whether it would re-enter the Eastbourne market even if the non-compete clause were removed.
91. In relation to Stagecoach's offer of a price cap in relation to prices in Eastbourne, the OFT notes that, as a general point, it is unlikely to consider that behavioural undertakings have sufficiently clear effects to address the

²⁷ See Completed acquisition by Stagecoach Group plc of Highland Country Buses Limited and Orkney Coaches Limited 17 October 2008, paragraph 46.

competition concerns identified in a merger.²⁸ The OFT sees no reason in this case why it would be appropriate to accept a behavioural undertaking given the risks in terms of effectiveness that they bring. Furthermore, such price control would be a poor substitute for price competition that could potentially have taken place absent the merger and would be unlikely to address any of the other quality or service benefits that competition can bring. Furthermore, it is not clear whether the competitive situation in Eastbourne would improve once the three year period had expired.

92. For these reasons, the OFT does not consider it appropriate to suspend its duty to refer to seek undertakings in lieu in this case.

DECISION

93. These mergers will therefore each **be referred** to the Competition Commission under section 22(1) of the Act.

ⁱ Renown has subsequently informed the OFT that Cavendish would have had to reduce its services.

ⁱⁱ Stagecoach has requested the Office to make clear that none of the references in the decision to responding, or retaliating, aggressively to entrants should be taken to imply conduct on the part of Stagecoach which is anything other than lawful competition.

²⁸ OFT Mergers – Substantive assessment guidance, para 8.10.