Anticipated acquisition by Arriva Northumbria Limited of the bus operations of Go North East Limited in Ashington, Northumberland

ME/4289/09

The OFT's decision on reference under section 33(2)(a) given on 11 February 2010. Full text of decision published 26 May 2010.

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. **Arriva Northumbria Limited (ANL**) operates commercial and tendered local bus services in the North East of England. ANL is controlled by **Arriva plc (Arriva),** one of the five largest bus and train operators in the UK.

2. The target comprises the local bus business that **Go North East Limited** (**GNE**) operates mostly out of its depot in Ashington, in Northumberland, which is north east of Newcastle (**the GNE Ashington assets**). GNE is controlled by the **Go-Ahead Group plc (Go-Ahead),** another of the five largest bus and train operators in the UK.

TRANSACTION

3. ANL intends to acquire the GNE Ashington assets which include: 25 buses; 17 commercial and tendered services;[1,2] staff; some residual stock at GNE's Ashington depot; and a six month rent-free licence for the use of Go-Ahead's Ashington depot. The bus services comprise three routes into

[1] Services number 30C, 32, 32B, X41, X42, X43, X44, X45, 144, 308, 322, 419, 438, 445, 873, 562 and 563. Most of these routes are either partially or totally subsidised. The OFT understand that at most four routes are entirely commercial. GNE is retaining the 318 (Ashington-Beddington-Cramlington-Newcastle) and the 309 routes (Blyth-Whitley Bay-Newcastle), as well as its Ashington depot. The 318 route stops in most of the populated areas where GNE is divesting other services to ANL.
[2] Contracted services 562, 563, 331 and 137/3.

Newcastle (from Ashington, Blyth, and Morpeth), two of which are commercial and one of which is a tendered Service.

4. As part of the consideration to be paid for the GNE Ashington assets, ANL has agreed to transfer to GNE a package of assets relating to its local bus business operating mostly out of its depot in Hexham, to the west of Newcastle **(the ANL Hexham assets)**.[3]

5. The administrative deadline of this case expired on 8 February 2010.

BACKGROUND

6. The acquisitions of the ANL Hexham assets and the GNE Ashington assets have been structured by way of two separate but interlinked sale and purchase agreements, each agreement being subject to the satisfactory completion of the other and each including a two-year non-compete clause.[4]

7. In summary, these transactions constitute an asset swap between GNE and ANL (the parties) of relatively similar portfolios in two territories extending from Newcastle within Northumberland and Tyne and Wear.[5]

JURISDICTION

8. The OFT believes that ANL and the combination of the GNE Ashington assets form two separate enterprises that will cease to be distinct for the purposes of the Enterprise Act 2002 (the Act) as a result of this merger.

9. The parties submitted that neither the turnover nor the share of supply test is satisfied. However, the OFT believes that the share of supply test under section 23(2) of the Act will be met as, post-merger, ANL will have an estimated share of supply of commercial and tendered bus services of 40 per cent measured by the number of buses in Northumberland, which the

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[3] The anticipated acquisition of the ANL Hexham assets by GNE has been assessed separately in case number ME/4288/09.

[4] The non-compete clause prevents GNE from re-entering those routes where the GNE Ashington assets are currently operating a service. It does not prevent GNE from entering any other routes where ANL is currently present.

[5] For consistency, these will be called Ashington and Hexham corridors in this decision. Corridor routes refer to routes along major road corridors carrying high volume traffic.

OFT believes to be a substantial part of the UK. This estimated share of supply includes an estimated increment of six per cent.

10. The parties argued that both sale and purchase agreements[6] should be assessed as a single relevant merger situation (if at all) given the way the transactions have been structured as a swap. This would also lead, according to the parties, to a 'net combined share of supply' whereby the increment in the share of supply for one transaction would be netted against the decrease in share of supply resulting from the other. In this case, the result of such a netting calculation would still be a small positive increment for ANL.

11. However, in any event, the OFT considers that these two transactions give rise to two separate merger situations on the basis that they involve two separate acquirers. In jurisdictional terms, the question in relation to each transaction is whether **that transaction** gives rise to an increment in the share of supply and the post-merger level is 25 per cent or more. As such, the netting approach advocated by the parties is not appropriate in this context.

12. Based on the above, the OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT FRAME OF REFERENCE - COMMERCIAL SERVICES

Product and Geographic Scope

13. The parties overlap in the supply of commercial (and tendered)[7] bus services in an area to the north east of Newcastle. This area includes the populated areas of Newbiggin-by-the-sea, Ashington, Blyth, Cramlington, Bedlington, Morpeth and along the coastline of Whitley Bay to Tynemouth on the A193 (**North East of Newcastle**).

14. The OFT has not found any reason to depart from its regular approach of considering commercial and tendered services to form distinct markets. The

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[6] Those are the separate agreements for the GNE Ashington assets and the ANL Hexham assets acquisitions which have been reviewed separately as noted in footnote 3 above.
[7] See paragraphs 71 to 73 below.

financial risks, business models and type of competition[8] are different for commercial and for tendered services. That said, it is not unusual that the same operators are active in both, that some operators consider both as a way of entry or expansion to achieve the necessary economies of scale and that 'commercial services' are often partially sponsored.

15. The OFT has not been presented with sufficient evidence to conclude that cars represent a suitable alternative to bus travel in this area. Hence it has excluded this form of transport from the product scope.

Point-to-point journeys

16. The OFT's assessment follows a similar approach to previous OFT and CC local bus cases by focusing on the competitive effects of the merger rather than specifically defining the appropriate relevant product or geographic market (albeit noting the distinction between commercial and tendered services). In practice, this means considering the competitive constraints (offered by the same or different modes) on a flow-by-flow basis in order to determine whether the merger may provide an incentive to increase fares or reduce service levels.[9]

17. The OFT has therefore focused in particular on flows on which both parties (actual competition) or either of the parties (potential competition) were operating pre-merger.

Network competition

18. More recently, both the OFT and the CC have, in certain cases, departed from a flow-by-flow analysis and instead considered all bus services in a specific geographic area together.[10] Such 'network competition' exists where:

[8] Competition 'for' the market in tendered services as opposed to competition 'in' the market for commercial services.

[9] See, for example, Competition Commission, *A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited* June 2004, OFT *Anticipated acquisition by FirstGroup plc of the Greater Western Franchise* 30 September 2005, *Completed acquisition by Stagecoach Bus Holdings Limited of Cavalier Contracts Limited* ME/3703/08.

[10] See, for example, OFT decision, *Completed acquisition by Stagecoach Group plc of Preston Bus*, ME/4032/09. See also footnote 1: *A report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited*, and *A report on the completed acquisition by Stagecoach Group PLC of Eastbourne Buses Limited and Cavendish Motor Services Limited.*

- on the demand side, a significant proportion of passengers buy network or multi-modal tickets, which allow them to travel on different routes or flows, for example by using different modes of transportation

- on the supply side, 'bus companies organise themselves around bus depots and fleets and the wider networks they operate; within these networks, existing operators can relatively easily switch buses between routes.' [11]

19. In this case, the parties contend that network competition occurs on a scale wider than the area to the North East of Newcastle where ANL and the GNE Ashington assets overlap. The parties explained that there are two available types of network tickets: passengers can either buy an ANL or GNE network ticket, or an NTL[12] network ticket. The NTL network ticket allows the use of any public transport within Tyne and Wear and represents a significant cost advantage over operator-specific network tickets.

20. There are certain features in this case which indicate that it is not appropriate to assess competition between ANL and the GNE Ashington assets at a 'network' level.

    - The GNE Ashington assets do not properly constitute a network of services (they comprise just three routes into Newcastle from Ashington, Blyth and Morpeth); this proposition is corroborated by the fact that only seven per cent of revenues are derived from network tickets.

    - While more significant than the GNE Ashington assets, ANL derives significantly less than half of its revenues (37 per cent) from network tickets; moreover, the OFT considers that this is likely to overstate the proportion of passengers benefiting from an ANL network given that Arriva's weekly network tickets are priced at a discount to five standard daily returns (in other words, a number of passengers buying a network ticket may be using it to travel on just one route for their

[11] CC inquiry relating to Arriva/Sovereign, paragraph 4.13.
[12] A network ticket from Network Ticketing Limited, a multi-operator travelcard revenue distribution scheme established by the operators in Tyne and Wear.

daily commute). As noted by the CC in *Stagecoach-Preston,*[13]the proportion of passengers who use 'network tickets' for true network use is usually lower than the total proportion of network tickets (relative to total tickets sold) might suggest.

- Unlike in *Preston*[14] and *Eastbourne,*[15] in which the merging parties' services substantially overlap, in this case, the parties flow overlap exclusively with relation to three main trunk routes, with no overlaps in local services.

21. In light of these facts, the OFT's assessment has primarily focused on the impact of the proposed merger on a flow-by-flow basis.

COMPETITIVE ASSESSMENT

Counterfactual

22. GNE submitted that the appropriate counterfactual was not the prevailing market structure but one where GNE's competitive constraint in these services to the North East of Newcastle is fading. In its view, this area is not able to support two national operators competing head to head. GNE argues that the negative financial results following recent increased competition against ANL, the failure of some planned bus services to business parks where patronage has been disappointing, and a decline in bus use in the region and the general economic outlook, have led GNE to review its strategy for the area and consider retrenching from its remaining commercial services. This, GNE contends, could also lead to the relinquishing of some of its tendered services if insufficient viable tendered volume was achieved.

23. These arguments by GNE can be assessed in two ways: either reviewing whether the criteria for failing firm apply leading to a departure from the OFT's standard counterfactual; or by taking into account GNE's expected weakening in its ability to compete against ANL when assessing the competitive assessment of this case.

[13] CC Report of 11 November 2009 on the completed acquisition by Stagecoach plc of Preston Bus Limited (paragraph 24 of Appendix I).
[14] See OFT decision of 28 May 2009 on the completed acquisition by Stagecoach plc of Preston Buses Limited (paragraph 54).
[15] See OFT decision of 13 May 2009 on the completed acquisition by Stagecoach plc of Eastbourne Buses Limited; and Cavendish Motor Services (paragraph 14).

24. In relation to the counterfactual, the OFT's starting point is that the pre-merger situation represents the most appropriate counterfactual against which to test the impact of the merger. In order for the OFT to depart from this and accept a 'failing firm' argument, the OFT must be satisfied that the following criteria are met:

- ME/4289/09there was no realistic and substantially less anti-competitive alternative to the merger.

25. GNE's latest financial results show that the commercial services directly affected by this merger were not meeting variable costs. However, GNE was still making profits on tendered services, including those affected by the merger. This resulted in an overall profit over variable costs on all 19 tendered and commercial services in the GNE Ashington assets. But, if the fixed costs of running the GNE Ashington depot were included the overall operation was making a loss.

26. Notwithstanding the financial difficulties facing GNE in relation to its Ashington assets, the OFT did not receive any evidence on their inevitable exit (or that there was no serious prospect of reorganising them). Various internal documents made it clear that consideration was being given to the future of the Ashington operations, including the possibility of service reductions and/or making changes to the Ashington depot (for example, there are references to the possibility of moving the depot to a 'low cost unit'). However, the evidence was inconclusive as to the likelihood and extent of any such changes, and how they would impact on the routes affected by the merger.

27. Moreover, the OFT did not receive any evidence on whether there was no substantially less anti-competitive alternative to the sale of the GNE Ashington assets to ANL.

28. Accordingly, the OFT has assessed this case against the prevailing pre-merger market structure given that neither criteria of the failing firm defence was met.

29. Notwithstanding this view on the counterfactual, the OFT has where appropriate considered in the context of its competitive assessment[16] whether the GNE Ashington assets form a weaker competitor than might otherwise be expected from a major bus company given their financial situation in this area.

UNILATERAL EFFECTS– COMMERCIAL SERVICES

Actual and potential competition analysis

30. The OFT has assessed the effect of this merger on actual and potential competition between the merging parties in line with its earlier precedents and the CC Transport Methodology. Actual competition refers to existing overlaps in flows while potential competition relates to the constraint on one party's ability to raise prices[17] posed by the threat of entry or expansion of the other party in a given flow.

Loss of actual competition

31. The competitive impact of this merger on flows on which the parties overlapped has been assessed in line with the Competition Commission (CC) methodology for Transport Inquiries.[18] This states that whether a merger in the transport sector may lead to a loss of effective competition depends on:

    - the relative importance of the overlapping flows. Routes for which overlaps account for less than 10 per cent of passengers and revenues are excluded

    - flows which are subject to 'effective competition' from third parties are excluded. The appropriate definition of an 'effective competitor' may vary depending on the circumstances of each case and will depend on relative frequencies or prices, and

[16] Also relevant for the assessment on whether it is appropriate for the OFT to apply its de minimis discretion in this case (see paragraph XX)
[17] Or reduce services.
[18] Competition Commission's 'Review of methodologies in transport inquiries' (CC Transport Methodology).

- whether it would be appropriate to exclude a flow because it is of relatively little importance in terms of revenue, number of passengers or frequencies. This threshold is typically set at £10,000 revenue a year.

32. Based on the above, the OFT's assessment filtered out 19 out of 28 overlapping flows[19] where the OFT concluded that ANL and the GNE Ashington assets are currently not 'effective competitors'. In addition, the OFT has excluded a further three flows on the basis that the revenue received from them was negligible.[20]

33. The merger therefore removes an effective competitor in the remaining six overlap flows, all affecting routes from Newcastle, travelling north or north east to Ashington, Morpeth, and Blyth. These flows, where ANL and the GNE Ashington assets were the only operators present, are addressed below.

Blyth to Newcastle

34. The GNE Ashington X42, X43, and 308 services overlapped with the ANL 42, 43, X1-6, 308, and 363/364 services. This affects revenue of [ ]. GNE will continue to operate its 309 service on the route (that is, they will not form part of the transaction). As a result, there will be no reduction in the number of operators on the route. However, GNE's retained services will be relatively limited and not sufficiently frequent for GNE to be considered an 'effective competitor' under the CC Transport Methodology. Technically, therefore, the transaction will result in a reduction in the number of 'effective competitors' on the route from two to one.

Ashington to North Seaton

35. The GNE X41 service[21] overlapped with the ANL X31 service. This affects revenue of [ ].

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[19] See full list of overlapping flows in Annex I and local map in Annex II below.
[20] This affects the following flows: Plessey Road to Newsham Black Diamond; Newsham Black Diamond to Shankhouse and Cramlington shops to Dudley (where the ANL services obtain less than 10 per cent of their revenue from this flow).
[21] GNE discontinued its X41 service eight months after the service had commenced in 2009. While the actual termination took place prior to the execution of the merger agreement, the OFT has not been presented with compelling evidence that this termination was unrelated to the merger discussions, which were already undergoing. Hence, the OFT cannot dismiss that the

Billy Mill to Willington Square and Norham Road to Newcastle

36. The merger removes GNE's 308 service which provides two buses per hour competing on-the-road with ANL's 306 and 44 services, which offer two to four buses per hour. This loss of actual competition affects a total revenue of [ ].

Blyth to Southfield Green and South Newsham to Southfield Green

37. The merger removes GNE's X42 and X43 services which provide one to two buses per hour competing against ANL's X2 or X3 services, which offer two buses per hour. These flows generate estimated total annual revenues of [ ].

Alternative competitive constraints

38. The parties submitted that, post-merger, the presence of Stagecoach in the Newcastle area will continue to exert a sufficient competitive constraint on ANL in relation to the overlap flows.

39. Stagecoach has two depots in Newcastle at Walkergate and Stayford from where it serves its routes to the suburbs to the North East of Newcastle in addition to one Newcastle service running from its depot at South Shields. There are some examples of Stagecoach altering its local services in the North East of Newcastle due to poor sales (low patronage), logistical and operational needs which corroborate its pro-active commercial policy. It also confirmed to the OFT during the course of its investigation that it has the capacity and willingness to expand its current services if commercial opportunities arose. The parties submitted that Stagecoach has a reputation as one of the most aggressive bus competitors.

40. Although the OFT did not receive any evidence from Stagecoach regarding specific entry plans for these particular overlap flows, the OFT considers it appropriate to distinguish the Blyth to Newcastle route from the other overlap flows. This is broadly for two reasons: first, the route is a significant trunk route with high passenger demand; and second, the

withdrawal of this service was merger-related. In light of this uncertainty, the OFT has taken a prudent approach and also assessed the impact of this merger taking as its counterfactual the pre-merger situation of GNE running the X41 service.

overlap between ANL and the GNE Ashington assets occurs across the whole route (as opposed to an overlapping flow that constitutes only a portion of a bigger route). These features make the route particularly conducive to entry. In this regard, the OFT considers that Stagecoach is particularly well placed to enter this route (if there were any lessening of competition arising out of the merger) given the close location of its depots and existing services and its stated capacity and willingness to expand services if commercial opportunities were to arise.

41. The incentive for entry by Stagecoach on the other overlap flows is likely to be less strong. Although the Blyth to Southfield Green and South Newsham to Southfield Green overlap is well placed for Stagecoach's depots and existing services, the flow is unlikely to represent a commercial opportunity in and of itself unless it were part of a larger expansion story (for example, where entry onto the overlapping flow formed part of an entry story onto a whole route or a network of local services).

42. In relation to other potential countervailing constraints, while there have been some recent examples of entry by local operators, this has been almost all in relation to tendered services only.

43. Moreover, while some local operators did express some interest in entering commercial routes if the commercial opportunity were to arise, they also stressed a certain reluctance to enter against a strong national player with a reputation for retaliation and with access to the financial resources to fund it. Their concern was that, post-merger, ANL will have such a large foothold in the area that it would not be viable to compete against it on commercial services. However, the OFT considers that these arguments applied already (given that ANL already has a significant foothold) and did not appear to be significantly aggravated by the transaction. Nevertheless, the OFT did not feel able to conclude with sufficient confidence that local operators would enter to offset any substantial lessening of competition on the overlapping flows.

44. Accordingly, with the exception of the Blyth to Newcastle flow, the OFT has not seen sufficient evidence to conclude that entry into the overlap flows would be timely, likely or sufficient to prevent or remedy the expected loss of competition resulting from this merger.

Conclusion on the loss of actual competition

45. Based on the above, the OFT concludes that this merger leads to a substantial lessening of competition on five flows on which the parties were in actual competition, affecting an estimated total revenue of [ ].

Loss of potential competition[22]

46. In recent cases, the CC has distinguished between 'actual potential competition', whereby one of the parties is actually planning to enter the other party's market, and 'perceived potential competition', where the behaviour of one of the parties is constrained by the theoretical possibility of entry by the other firm.[23]

47. In past bus mergers, when assessing potential competition between the parties, the OFT and CC have examined factors such as the parties' past movements onto each other's routes, expansion of their services, internal documents and whether one of the parties sought to 'protect' its routes from entry by offering higher frequencies and lower rates.[24] The OFT here, has followed a similar approach in order to assess perceived and/or actual potential competition between the parties.

48. All the actual overlaps in the supply of commercial services in Ashington affected by this merger have been created or extended by recent direct competition between the merging parties.[25] The OFT has not, however,

[22] The discussion in this section focuses on the loss of any potential competitive constraint by the GNE Ashington assets on ANL (and not vice versa). This is because ANL is already actually competing on all flows where the GNE Ashington assets are present.

[23] For a discussion (including of the strict evidentiary thresholds that apply to both) see OFT decision of 9 May 2008, *Completed acquisition by Air France Finance S.A.S/ City Jet Ltd of VLM Airlines N.V.* paragraphs 106-ff.

[24] See, for example, OFT decision, *Completed acquisition by Stagecoach Group plc of Preston Bus*, ME/4032/09. See also footnote 1: *A report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited.*

[25] In particular, the OFT understands that the X42/X43 service was started by GNE in September 2006, before both parties reduced fares in the Cramlington corridor. GNE then introduced the 309 service to Blyth in March 2007, purchased local operator Northumbria Coaches in September 2007 and started the X44/X45 service in November 2008. Arriva then introduced the 43A and 307 services, although the 43A service does not appear to operate from ANL's Ashington depot and the 307 service does not appear to operate in the Ashington area. Arriva also increased frequency on the 308 service in February 2009. A week later, GNE introduced the X41 service (which was withdrawn in October 2009) and increased frequency on the 308 service (which appears to be a service jointly run by ANL and GNE). At the end of March 2009, after merger discussions between the parties were underway, Arriva introduced the X30 service (from Ashington to Newcastle).

seen any evidence suggesting that GNE was planning to launch any further services of this type in competition with ANL (which may be in part because of the deteriorating financial position of the GNE Ashington assets). Therefore, this assessment has focussed on the possible loss of perceived potential competition (as opposed to perceived potential competition where actual entry is being planned).

49. In this context, the OFT has considered those flows where either of the parties is present **as well as** the 19 flows where both parties are present but which were filtered out following the application of the CC Transport Methodology (on the basis that one of the parties was not considered an effective competitor due, for example, to a limited presence on the flow).

Loss of perceived potential competition in overlapping flows (previously filtered out from loss of actual competition)

50. In considering the loss of perceived potential competition arising from the merger, the OFT has considered whether there are other, at least, equally well placed operators in the area.

51. The main flows which were filtered out arise in three long corridors affected by the merger (Blyth-Cramlington-Newcastle, Ashington-Newcastle, and Morpeth-Newcastle). They all originate in Newcastle where Stagecoach has two depots and already runs local bus services. The OFT notes the similarity with the situation in the Hexham 'corridor' in which Stagecoach runs intercity services along the corridor from its depots in Newcastle (and with the Blyth to Newcastle flow discussed above). The OFT also notes that Stagecoach has indicated its continued interest in developing business opportunities despite the fact that, at present, it does not have any definite plan to expand into these corridors.

52. Internal documents from the merging parties identify Stagecoach as an important competitor and both parties monitor its activities (as well as those of other local operators in addition to each other's). Also, ANL internal documents indicated that it was aware that the GNE Ashington assets were facing financial difficulties and that the sustainability of these routes was in doubt. ANL told the OFT that it believed that the fixed costs of the GNE Ashington depot was one of the main reasons for the negative financial results.

53. A combination of Stagecoach's presence in the area, ANL's awareness of Stagecoach and its actual knowledge of the financial difficulties facing the GNE Ashington assets led the OFT to conclude that the GNE Ashington assets were not a particular (or unique) constraint on ANL by way of perceived potential competition on these particular flows.

54. As such, the OFT believes that the merger does not result in a substantial lessening of competition through the loss of perceived potential competition with regard to these flows.

Loss of perceived potential competition in non-overlapping flows

55. GNE operates virtually no local services to the North East of Newcastle with the Ashington assets. Hence there is no actual overlap with ANL's multiple local services in the towns of Blyth, Morpeth, Ashington, Newbiggin-by-the-sea, Cramlington and Bedlington. The OFT has considered it helpful to assess whether there is a loss of perceived potential competition by drawing a distinction between non-overlap routes to the north and south of Cramlington.

South of Cramlington – Stagecoach and GNE remain potential competitors

56. The OFT considers that Stagecoach represents an equally effective constraint on ANL as the GNE Ashington assets in the area to the south of Cramlington. This is based on the proximity of Stagecoach's existing services and depots, recent examples of changes to its local services and its proven willingness to take on new commercial opportunities in the area.[26]

57. Moreover, the OFT notes that the non-compete clause agreed by the parties does not prevent GNE from entering on these non-overlapping routes. It is therefore possible that GNE could also potentially enter these flows from its depots in Newcastle and at North Tyneside. The ability of GNE to enter these flows – and therefore any perceived potential constraint imposed by it on ANL - is not affected by this transaction.

[26] Stagecoach has increased the frequency of its services between Newcastle and Carlise and expanded in Sunderland.

58. Based on the above, the OFT believes that the merger does not result in a substantial lessening of competition through the loss of perceived potential competition with regard to services between Cramlington and Newcastle.

North of Cramlington

Pre-merger GNE constraint

59. Three factors support the proposition that GNE has the ability to expand its services, in particular to the north of Cramlington in response to a reduction in the offering of ANL. This could suggest that GNE perceived potential constraint on ANL is particularly significant to the north of as opposed to the south of Cramlington. These factors are:

- its depot in Ashington
- that it holds several tendered service contracts for local bus routes and is bidding for more and
- that the GNE Ashington assets form part of a large national operator with significant financial resources compared to local operators.[27]

60. GNE contends that it would not have had any **incentive** to expand its Ashington assets onto new flows and routes given that it has incurred significant losses in the area and failed to meet its internal targets for commercial services. The business was financially distressed and the OFT understands that ANL knew of its weaknesses; knowledge that is likely to have reduced its concern about the ability of GNE to enter in response to a commercial opportunity.

61. The OFT notes that GNE is keeping its Ashington depot[28] thereby providing the opportunity post-transaction to expand into those local markets north of Cramlington. This might suggest that the merger does not substantially change the pre-merger situation. In this respect, the OFT also notes that the impact of the non-compete clause is relatively limited in the area (in

[27] The OFT notes that these factors could also apply, to varying degrees, to GNE's ability to expand south of Cramlington. It would note, however, that the Ashington depot is better located for services to the north of Cramlington, and that the large proportion of its tendered contracts are also in this area.
[28] Although the OFT acknowledges GNE's short term intention of mothballing that depot.

light of the limited presence of the GNE Ashington assets to the north of Cramlington - except in relation to tendered services). However, operating from a depot can have considerably higher costs than 'mothballing' one, so GNE is likely to be reluctant to use the Ashington depot (after ANL's six month license on it expires) to launch new services unless depot overheads will be covered.

62. Overall, the evidence before the OFT shows that GNE has historically represented ANL's most significant potential competitor (and vice versa). Its presence has resulted in more services and, according to third parties, lower prices not only on overlaps where it is an effective competitor but also on some non-overlap flows to the North East of Newcastle suggesting perceived potential competition has operated for the benefit of passengers.

Constraint provided by local operators

63. Local operators such as Phoenix Coaches and Astley Coaches provide a limited level of local commercial services: in Blyth, Ashington, and Newbiggin-by-the-sea in the case of Phoenix Coaches; and in Morpeth, Ashington, and Bedlington in the case of Astley Coaches. There is also a wide range of other bus and coach firms in the area that offer some tendered services (for instance school contracts). These services are not sufficient to be considered as 'effective competitors' as they do not overlap[29] and there is no evidence that ANL has considered them potential competitors to date. However, their relative importance is noted given their local expertise, their stated willingness to expand at least into further tendered work and available spare capacity.

64. Some local operators have recently re-entered the market after the expiry of certain non-compete clauses arising out of previous acquisitions in the area although mostly in relation to tendered services. The OFT found some willingness amongst these local operators to expand into commercial services north of Cramlington (although their initial plans focus on tendered contracts). However, as noted above, these local operators also expressed some reluctance to enter against a strong national player with a reputation for retaliation and with access to the financial resources to fund such action. Accordingly, on a cautious basis, the OFT could not confidently

[29] Pursuant to CC Transport Methodology.

conclude that these operators would present a material constraint on ANL, in particular in relation to commercial services.

Constraint provided by Stagecoach

65. The impact of the merger is potentially aggravated by the fact that both parties are national companies (as opposed to independent local bus operators). The OFT is mindful of the conclusion of its recent Market Study on Local Bus Services[30] which has found that that a reduction in the number of national players in local areas (regardless of whether there are actual flow overlaps between the parties) from two-to-one and from three-to-two leads to a significant price increase. These findings make the OFT particularly cautious about a loss of potential competition.

66. Both parties pointed out that Stagecoach has the reputation of competing aggressively if the commercial opportunity arises and Stagecoach confirmed to the OFT that it monitors commercial opportunities in the affected area. However, the OFT notes that Stagecoach does not have immediate plans to expand in the area.

67. Further, the incentives for Stagecoach to expand into local services around Blyth, Ashington, Morpeth and Newbiggin-by-the sea may be dampened by the distance from these routes to its depots and by the relatively lower revenues to be made on them in comparison to longer corridor routes. This contrasts with Stagecoach's position in the area to the south of Cramlington where it is much better placed due to the closer location of its existing services and depots.

Conclusion – North of Cramlington

68. Based on the above, the OFT considers this merger gives rise to a realistic prospect of a substantial lessening of perceived potential competition on those flows north of Cramlington. The constraint from local operators has been limited to date, their expansion in the short- to medium-term is uncertain and it is not realistic to expect that Stagecoach imposes a credible constraint either.

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[30] OFT158- Local Bus Services: The OFT's reasons for making a market investigation reference to the Competition Commission. January 2010.

Conclusion on potential competition

69. In summary, the OFT believes that this merger gives rise to a realistic prospect of a substantial lessening of perceived potential competition in the area north of Cramlington. However, the OFT believes that the merger does not give rise to a realistic prospect of perceived potential competition either in the Blyth-Cramlington-Newcastle, Ashington-Newcastle, and Morpeth-Newcastle corridors, or in the area to the south of Cramlington.

70. The value of the markets affected by the substantial lessening of perceived potential competition north of Cramlington is estimated to be [ ].[31]

UNILATERAL EFFECTS –TENDERED SERVICES

71. NCC and Nexus procure local bus services that private operators would find unprofitable to run in Northumberland and Tyne and Wear, including the area to the North East of Newcastle. In doing so, the local authority specifies the terms and conditions of the tendered service — for example routes, frequency, the type of buses to be used, fares, and quality standards — and then invites operators to submit bids for running the service, which is wholly or partly subsidised. Contracts are re-tendered every few years. Current contracts in the Ashington area generally run for four years from September 2006 and are due to expire in September 2010. The tenders from public authorities refer to specific routes, suggesting that the relevant geographic scope of each differs.

72. Two local councils were concerned about the reduction in the number of bidders, in particular the possible loss of a national operator, in the forthcoming rounds of tenders. These authorities were not able to supply information on whether the rivalry between ANL and GNE in tendered services has been a key driver of competition in tendered services. However, the OFT was able to confirm that an average of four bidders per contract had participated in the most recent tendering process, including Stagecoach. Moreover, GNE noted that the transaction did not prevent it from bidding for tendered services in the future (for example, the non-compete clause does not prevent this) and in fact that it was already doing

[31] This figure is ANL's commercial revenues in the area. GNE does not operate any services in the area and the revenue that other operators earn is either from tendered services or is not significant.

so. In other words, it was not necessarily the case that the transaction would result in the loss of a national operator in future bidding rounds.

73. In addition, two local bus operators confirmed that they are intending to bid in the forthcoming rounds of tenders. Many of these bids are for small, low-value contracts for which these firms believed they are competitive.

74. In light of the above, and in the absence of evidence corroborating the concerns initially expressed by third parties, the OFT does not believe that there is a realistic prospect that this merger will result in a deterioration of the prices (or non-price factors such as level of frequency and quality of buses) secured by local authorities for tendered services that they would have been able to achieve absent the merger.

COORDINATED EFFECTS

75. The OFT has considered whether the merger might be expected to give rise to a realistic prospect of a substantial lessening of competition based on coordinated effects, that is, whether the merger creates or enhances the prospect that the parties could engage in (tacit or explicit) collusion in the supply of bus services in the area around Newcastle.

76. Coordination may arise when a market meets certain conditions.[32] Specifically, that the merger must (i) enable (or strengthen the ability) of firms to reach and maintain the terms of coordination, (ii) create or ensure that coordination is internally stable (that is, that firms have the incentive to maintain coordination) and (iii) create or ensure that coordination is externally stable (that is, is not defeated by fringe competitors, entry or buyer power).

77. In the present case, the OFT's concerns were that the merger may give rise to coordinated effects in the form of geographic route sharing to the north and south of the river Tyne in the area around Newcastle. The OFT carefully considered the rationale for the transaction and conducted a review of the internal documents provided by the parties. On this basis, the

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[32] See for example, the OFT's *Mergers Substantive Assessment Guidance,* paragraph 4.11 to 4.16, and the OFT decisions of 12 December 2007 regarding the anticipated mergers between First Milk Limited and Milk Link Limited, and 11 December 2006 regarding the anticipated acquisition by Wienerberger Finance Services BV of Baggeridge Brick plc).

OFT concluded that there was no evidence of pre-existing coordination between the parties of this type in this area.

78. Having concluded that there was no evidence of pre-existing coordination between the parties, the OFT then considered whether the transaction could enhance the prospects for such coordination in the future.

79. In conducting its analysis, the OFT considered the firms' incentives to coordinate are likely to be best aligned where they are symmetric (so that each has the same to gain from coordinating or the same to lose from not coordinating). In this case, the question is whether this merger results in a geographic market sharing leading to the parties having more 'symmetric' activities[33] in this area (ANL north and GNE south of the River Tyne). The OFT's analysis concluded that the merger was not likely to give rise to future coordination in the form of geographic route sharing as each of the parties is — even post-merger — active on routes to the north and south of the Tyne. In particular, the parties submitted that, post-merger, ANL and GNE will still face direct competition from each other for over 90 per cent of the revenues that they directly competed for pre-merger in the North East of England. Therefore, this transaction does not significantly reduce the degree of competitive interaction between the parties in the North East and is not therefore likely to lead to co-ordination.[34]

80. In addition, in considering whether this transaction, seen in the context of a wider asset swap between the parties,[35] could facilitate future coordination in the form of geographic route sharing, the OFT notes that the presence of a significant competitor (such as Stagecoach) would present an external destabilisation through possible entry and/or expansion for larger corridor routes post-merger.

81. Accordingly, in light of the above, the OFT does not believe that the acquisition by ANL of the GNE Ashington sets would, in itself, increase the

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[33] In volume or value terms.

[34] Newcastle – Blyth (ANL 308/GNE 309), Newcastle – Tynemouth (ANL 306/GNE 75/76), Newcastle – Durham (ANL X1, X2/GNE 21) Newcastle – Middlesbrough (ANL X1, X2/GNE X9, X10), Sunderland – Hartlepool (ANL 23/GNE X35), Durham – Langley Park (ANL 754/GNE 13, 14) Newcastle – North Shields (ANL 356/306/GNE 1,2/75, 76), Newcastle – Whitley Bay (ANL 355/44/GNE 309/75 & 76), Sunderland to Peterlee (ANL 21/21A/GNE 60/X35), Bishops Auckland – Newcastle (ANL X24/GNE 21/X28).

[35] The anticipated acquisition of the ANL Hexham assets by GNE has been assessed separately in case number ME/4288/09.

probability that the parties will collude (tacitly or explicitly) in the markets for the supply of bus services in the area around Newcastle.

THIRD PARTY VIEWS

82. The OFT has contacted a number of third parties including local representatives, users' associations and companies listed by the parties as operating in or close to the relevant areas. The responses have been mixed but three features appear regularly: the parties are already the largest competitors in the area; third parties are reluctant to enter or expand their services in fear for retaliation from these large national operators; and the transaction might remove an important national competitor for the next tendering processes.

ASSESSMENT

83. The merger will result in ANL and the GNE Ashington assets overlapping in commercial and tendered bus services on a number of bus flows in the area to the North East of Newcastle. The OFT analysed the effects of the transaction on a flow by flow basis.

84. The OFT considered whether it would be appropriate to depart from its counterfactual of the pre-merger market structure but concluded it would not be appropriate to do so.

85. Of the 28 overlap flows between the parties, the OFT considered that competition concerns arose on five; Ashington to North Seaton, Billy Mill to Willington Square, Norham Road to Newcastle, Blyth to Southfield Green, and South Newsham to Southfield Green. The OFT excluded three flows out of 28 on the basis that the revenue received from them was negligible. The OFT filtered out 19 flows of 28 pursuant to the CC Methodology for Transport Inquiries on the basis that competitive interaction between the parties pre-merger was limited or on the basis of the presence of other effective competitors. The preliminary concerns raised with regard to the remaining flow that comprises substantially the entire Blyth to Newcastle route were dismissed after concluding that in light of the infrastructure available in the area, it is feasible to run the complete services from one of the ends of the route for those operators with depots near the route (most significantly Stagecoach) given the absence of any local network to replace.

86. The OFT also considered whether the parties constrained each other through potential entry and the threat of potential entry on flows where they currently do not overlap (or where they overlap but were not effective actual competitors). While the evidence available to the OFT indicates that the parties have been registering routes against each other and have been actively monitoring each other's pricing and strategies, the OFT has not seen any evidence suggesting that GNE was planning to launch any further services in competition with ANL (which may be in part because of the deteriorating financial position of the GNE Ashington assets. This dismisses the OFT's preliminary concerns on the loss of actual potential competition.

87. This merger removes an important perceived potential competitor, in particular with regard to the area north of Cramlington. This area is closer to GNE’s Ashington depot and distant from Stagecoach’s Newcastle depots. The constraint from local operators which operate local services in towns north of Cramlington has been limited to date, their expansion in the short- to medium-term is uncertain. Further, the incentives for Stagecoach to expand into local services around Blyth, Ashington, Morpeth and Newbiggin-by-the sea may be dampened by the distance from these routes to its depots and by the relatively lower revenues to be made on them in comparison to longer corridor routes. This contrasts with Stagecoach’s position in the area to the south of Cramlington where it is much better placed due to the closer location of its existing services and depots. For these reasons, the OFT believes that this merger gives rise to a realistic prospect of a substantial lessening of perceived potential competition in the area north of Cramlington.

88. The competitive situation appears different with regard to services to the south of Cramlington and overlap flows. Based on ANL's internal documents and replies from the OFT market review, Stagecoach impose as effective perceived competitive constraint on both parties as each party on each other. This applies equally to local routes to the south of Cramlington and overlap flows which have been filtered out pursuant to the CC Methodology for Transport Inquiries. Stagecoach's presence in this area is more significant, there are no local services to replicate and Stagecoach's incentive to run substantially more financially significant services make its perceived potential constraint on ANL to become more significant with regard to local routes to the south of Cramlington and those 19 overlap flows which had been filtered out. As a result, the OFT does not believe that the loss of the perceived potential competition between ANL and GNE

Ashington assets could lead to the realistic prospect of a substantial lessening of competition with regard to these services.

89. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

90. On this basis, the OFT is under a duty to make a reference to the CC. However, the OFT has considered whether it would be appropriate to exercise its discretion to apply one of the exceptions to the duty to refer pursuant to either section 33(2)(a) or 33(2)(c) of the Act to the facts of this case.

EXCEPTIONS TO THE DUTY TO REFER

Introduction

91. The OFT's duty to refer under section 33(1) is subject to the application of certain discretionary exceptions, including the markets of insufficient importance or *de minimis* exception under section 33(2)(a).

92. For the reasons explained in *Dunfermline,*[36] the OFT believes that it would be proportionate not to apply the *de minimis* exception where it considers that in principle a clear-cut undertaking in lieu of reference exists that could be offered by the parties.

93. The OFT did not consider, based on its objective evaluation of the transaction, that this case was a clear candidate for resolution by means of undertakings in lieu. This is because, in the circumstances of this case, divestment of an individual route may not in itself be a viable and effective remedy in the absence of related assets (in particular, a suitably located depot).

94. Moreover, as stated in *Stagecoach,*[37] the OFT does not consider that a package of behavioural remedies would in principle be available as a first-

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[36] OFT's decision of 4 February 2008 on the completed acquisition by Dunfermline Press Limited of the Berkshire Regional Newspapers business from Trinity Mirror plc (paragraphs 100-115).
[37] OFT decision of 4 February 2008 on the completed acquisition by Stagecoach Group plc of the East Midlands (paragraph 70)

phase remedy in this sector. In the OFT's experience, behavioural remedies, tend to fail the clear-cut standard of undertakings in lieu because they are costly and yet of questionable effectiveness.

Application of the OFT's de minimis exception

95. In relation to the OFT's de minimis discretion under section 33(2)(a),the relevant factors that the OFT considers in determining whether it should apply this discretion are:

- the **market size**
- 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
- whether any value should be attributed to **deterrence** (in terms of deterring future similar potentially anti-competitive transactions).

96. The parties submitted that the OFT should apply its de minimis discretion not to refer the merger to the CC as the affected markets are of insufficient importance and, in their view, assessment of the above factors should encourage the OFT to exercise its discretion in this case. The OFT has considered each of the above factors in turn below.

Market size

97. The OFT has concluded that this merger gives rise to realistic prospect of substantial lessening of competition affecting markets worth an estimated £4.1 million. This is below the £10 million threshold above which de minimis will not be applicable. This total is arrived at by adding the [ ] estimated value of the market affected by the loss of actual competition to the [ ] million value of the markets affected by the loss of potential competition. Being just below the middle of the de minimis scale, this slightly directs towards the application of the discretion.

Strength of OFT's concerns

98. The merger results in a reduction in the number of competitors from two to one on five flows. Set against this, the OFT notes the presence of other

bus operators including Stagecoach in the area to the North East of Newcastle. Much of the OFT's concern also relates to the loss of 'perceived potential competition' that GNE has imposed on ANL.[38] On this basis, the OFT's overall level of concern of harm materialising is closer to 'realistic prospect' than to 'balance of probabilities' which would direct the de minimis gauge towards the application of the OFT discretion based on this parameter.

Magnitude of competition lost

99. In addition to the factors mitigating the strength of the OFT's concerns, the parties submitted that the magnitude of competition loss is reduced in light of the expected weakening of the competitive constraint GNE Ashington assets confers on ANL. The evidence submitted by the parties did not corroborate that GNE Ashington assets met the criteria of a 'failing firm' and were inconclusive on the extent of this alleged reduction going forward (absence the merger).[39] Consequently, this criterion cannot point towards the application of de minimis discretion.

Durability

100. While competitors have not stated that they will enter the actual overlapping flows, there are a number of active competitors in the relevant area, including one large national operator (Stagecoach). The same situation exists to the area to the north of Cramlington where the OFT identified potential competition concerns. This would tend to suggest that the duration of the expected consumer harm will be no greater than average, and therefore this factor should be neutral in terms of whether de minimis should be applied.

Consideration of any deterrence value

101. The OFT is conscious that an exercise of the de minimis discretion in this case could potentially result in similar potentially anti-competitive transactions being structured going forward on the expectation that the OFT would once again exercise its de minimis discretion. In this case, the substantial lessening of competition goes to the heart of the transaction

[38] See paragraph 61 above.
[39] See further paragraphs 60-62 above.

(rather than the lessening of competition being incidental to a generally benign transaction) and for that reason consideration of the deterrence value of the decision points against the exercise of the de minimis discretion.

Conclusion on de minimis

102. Overall, the OFT considers that this is an appropriate case for it to exercise its discretion not to refer because the markets concerned are of insufficient importance to warrant a reference. Based on the facts of this case and in particular that the majority of concerns arise relates to the loss of potential, rather than actual, competition; and that Stagecoach and GNE will remain active in the area after the transaction as well as other local operators, have led the OFT to conclude that it is appropriate to exercise its de minimis discretion not to refer.[40]

DECISION

103. This merger will therefore not be referred to the CC pursuant to section 33(2)(a) of the Act.

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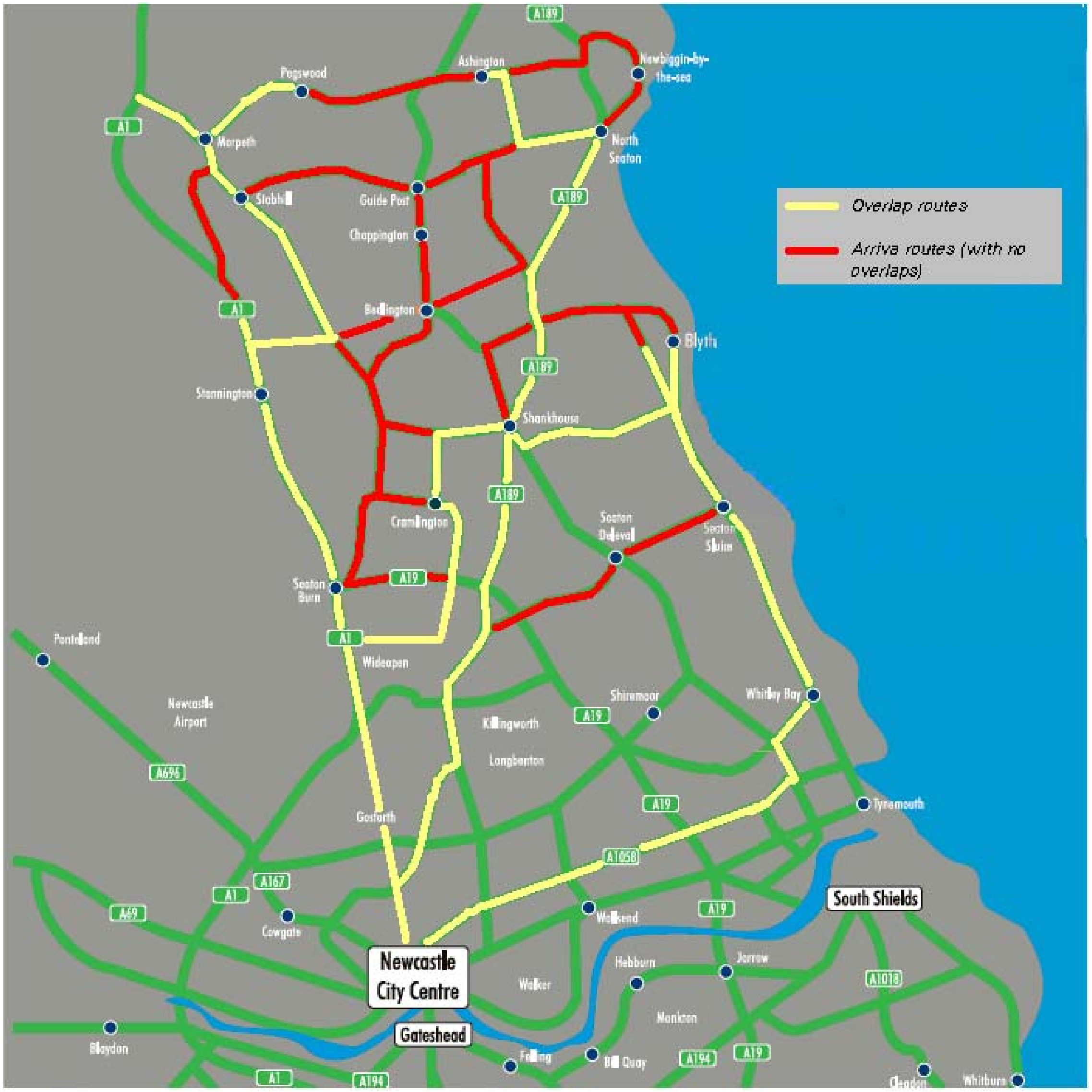
[40] The OFT has therefore not needed to consider the application of the customer benefits exception under section 33(2)(c) of the Act.

Annex I

Flow	Loss of Effective Competition	Reason
Flows with no loss of effective competition		
Ashington – Newcastle	No	Parties are not effective competitors due to frequency.
Whitley Bay – New York	No	Parties are not effective competitors and GNE will continue to operate on this flow.
Kings Road – Newcastle	No	GNE will continue to operate services on the flow.
Newcastle – Morpeth	No	GNE operates half as frequently as Arriva, 36per cent price differential.
Regent Centre – Newcastle	No	Parties are not effective competitors due to frequency.
Blyth – Renwick Road	No	GNE service 309 will continue to operate on the flow.
E/W Link Road – Cramlington Shops	No	Parties are not effective competitors due to frequency.
Cramlington Shops – Newcastle	No	Parties are not effective competitors due to frequency. Also rail competition exists.
Dudley – Newcastle	No	Parties are not effective competitors due to frequency.
Wideopen – Newcastle	No	Parties are not effective competitors due to frequency.
Hazelrigg Road End – Newcastle	No	Parties are not effective competitors due to frequency.
Brunton Park – Newcastle	No	Parties are not effective competitors due to frequency.
Gosforth – Newcastle	No	Stagecoach is an effective competitor.
Morpeth – Clifton	No	Parties are not effective competitors due to frequency.

Seaton Burn – Newcastle	No	Parties are not effective competitors due to frequency.
Bluehouse – Newcastle	No	Parties are not effective competitors due to frequency. Also Stagecoach is an effective competitor.
Pegswood – Morpeth	No	Parties are not effective competitors due to frequency.
Morpeth – Stobshill	No	Parties are not effective competitors due to frequency.
South Beach – Seaton Sluice	No	Note however GNE continues to operate the 309 service.
Flows with loss of effective competition but described as negligible		
Newsham Black Diamond – Shankhouse	Yes- Negligible	GNE operates half as frequently as Arriva
Plessey Road – NewshamBlack Diamond	Yes- but negligible revenues	GNE operates half as frequently as Arriva
Cramlington Shops – Dudley	Yes- but may not be substantial part of route	GNE operates half as many buses as ANL, there is a 27 per cent price differential.
Blyth – Newcastle	Yes but trunk route with substantial revenue and GNE still active	GNE is effective competitor pre-transaction, but is not post-transaction, but retains 309 service (4 buses an hour) ANL have 16 buses on 8 routes.
Flows with loss of effective competition leading to SLC		
Ashington – North Seaton	Yes	Prices differ by 15 per cent.
Blyth – Southfield Green	Yes	GNE operates half as frequently as Arriva with a 30 per cent price differential.
South Newsham – Southfield Green	Yes	30 per cent price differential.
Billy Mill – Willington Square	Yes	GNE operates half as many services, 18 per cent price differential.
Norham Road – Newcastle	Yes	22 per cent price differential.

Annex II


Overlap routes
Arriva routes (with no overlaps)
Newcastle City Centre
Gateshead
South Shields
Ashington
Pegswood
Morpeth
Newbiggin-by-the-sea
North Seaton
Guide Post
Choppington
Stannington
Blyth
Shankhouse
Seaton Delaval
Seaton Burn
Wideopen
Ponteland
Newcastle Airport
Shiremoor
Whitley Bay
Killingworth
Longbenton
Tynemouth
Gosforth
Cowgate
Wallsend
Walker
Hebburn
Jarrow
Monkton
Blaydon
Bill Quay
Whitburn
A1
A189
A19
A696
A1058
A167
A69
A194
A1018