

Completed acquisition by Go North East of Stanley Taxis

ME/3404/07

The OFT's decision on reference under Section 22(1) given on 18 March 2008.
Full text of the decision published on 1 April 2008.

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

PARTIES

1. **Go North East Limited** (Go North East) is a wholly owned subsidiary of Go-Ahead Group plc. Together with its sister companies Go Wear Buses Limited and Go Northern Limited it trades as Go North East and operates commercial and tendered local bus services in the North East of England.
2. **Stanley Taxis** operated commercial and tendered local bus services in County Durham and Tyne and Wear. It comprised the bus operations of RM Scott and Partners, with 13 buses, 16 personnel and some equipment. Stanley Taxis' UK turnover in its last financial year was [below £1 million].

TRANSACTION

3. Go North East acquired Stanley Taxis on 15 October 2007. The extended administrative deadline is 20 March 2008 and the extended statutory deadline is 20 April 2008.

JURISDICTION

4. As a result of this transaction Go North East and Stanley Taxis have ceased to be distinct. The parties overlapped in the supply of commercial and tendered local bus services in the area where Stanley Taxis was active, consisting of Derwentside (part of County Durham), Gateshead, Sunderland and Newcastle (all part of Tyne and Wear), which the OFT believes forms a substantial part of the UK. The OFT believes the parties' combined share of supply of commercial and tendered local bus services in this area exceeded 25 per cent. As a result, the share of supply test in section 23 of the

Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

Product scope

5. In previous cases, the OFT and the Competition Commission (CC) have distinguished between commercial local bus services and tendered local bus services.¹ This distinction was supported in this case by Go North East. Tendered services are subsidised by the local authority in order to provide transport services in areas where operators would otherwise find it unprofitable to operate commercial services. Bus operators bid for contracts for tendered services, which are re-tendered every few years and cover key aspects of the services, which may include fares, timetables and frequencies. Hence, competition in tendered services occurs at the bidding stage rather than in the operation of the service. In this case, at the time of the merger both Go North East and Stanley Taxis operated tendered services under contracts with Nexus (the Tyne and Wear Passenger Transport Executive) and Durham County Council (Durham CC).
6. On the supply side, many of the commercial operators in the area where Stanley Taxis was active also operate tendered services. However, supply-side substitution between tendered and commercial services may not be symmetric, as tendered operators may find it more difficult to start to operate commercial services than the other way around. These two types of service have very different pricing mechanisms. An operator of a tendered service begins operations with effectively a guaranteed revenue stream, which makes investments and other business decisions less risky.
7. On the demand side, passengers are unlikely to differentiate between a tendered service and a commercial service. Some overlap existed between commercial services run by Go North East and tendered services run by Stanley Taxis. However, as Nexus and Durham CC both regulate bus fares and timetables or frequencies for tendered services,² Go North East is very limited in its ability to change these.
8. Based on the factors set out above, the OFT considers that there is no reason for it to depart from its previous approach to consider commercial and tendered services as separate product frames of reference.
9. As regards tendered services, as noted above, the merged parties both operated tendered services for Nexus and Durham CC. There is no demand-

¹ See most recently the OFT's decision of 10 January 2008 regarding the anticipated acquisition by Greater Manchester Buses South Limited of A. Mayne & Son Limited, citing earlier cases.

² Nexus determines the exact fares as well as frequencies, while Durham CC determines maximum fares and timetables.

side substitutability, as these authorities only contract services for their own areas (even where services cross area boundaries). On the supply side, as most operators bid for several services in an area, the OFT does not in this case consider individual tendered service contracts to form separate product frames of reference. However, while there are some bus operators that bid for services tendered by both Nexus and Durham CC, there are also a significant number of operators who bid for services tendered by only one of these authorities. This is due, for example, to the distance of route start and end points from their depots. The OFT has therefore taken a cautious approach and considered services tendered by Nexus and services tendered by Durham CC as separate product frames of reference.

10. Finally, taking a cautious approach, as in previous cases, the OFT has not included other modes of transport such as the car in the relevant product frame of reference.

Geographic scope

11. As the parties overlapped in the area consisting of Derwentside, Gateshead, Sunderland and Newcastle, the OFT has restricted its assessment to this area. In previous cases, the OFT and the CC have considered local markets in commercial services on the basis of competing services on point-to-point flows, as a particular origin/destination combination is not likely to be substitutable with other origin/destination combinations from a passenger's point of view.³ In this case, the OFT considers that the commercial routes operated by the parties at the time of the merger extended to both urban and rural areas. For the urban areas, in its analysis of the effects of the merger, the OFT has considered that flows overlap where the parties' respective bus stops were within 400 metres of each other.⁴ For the rural areas, the OFT has considered that flows overlap where the parties' services served the same settlement, regardless of bus stop location.
12. Supply-side substitution may be possible, depending for example on the location of competing operators' routes and depots.
13. In this case, the OFT has taken a cautious approach and, in line with past cases, has considered individual flows as the relevant geographic frames of reference for commercial services. The possibility of competing operators entering these or similar flows is discussed in the section on barriers to entry and expansion below.

³ See footnote 1. A flow consists of (part of) a route from a point at which passengers get on the bus to a point at which they get off.

⁴ See for example the CC's report of 8 March 2006 on the acquisition by First Group plc of the Greater Western Passenger Rail Franchise. See also the CC's report *Review of methodologies in transport inquiries*, May 2007, paragraphs 18-24.

14. For tendered services, the geographic frame of reference is determined by the product frame of reference. Accordingly, the appropriate geographic frames consist of the areas covered by Nexus and Durham CC respectively.

HORIZONTAL ISSUES

Tendered services

15. Go North East submitted that following the merger there are still sufficient competing operators, including the national operators Stagecoach and Arriva, active in the areas for which Nexus and Durham CC secure tendered services. However, both Nexus and Durham CC expressed concern about the reduction in potential bidders for tendered services as a result of the merger.

Services tendered by Nexus

16. Nexus informed the OFT that from 2005 to 2007 ten different operators won tendered contracts. In these three years Go North East won 61 per cent of tenders (on average 113 contracts were tendered each year), while Stanley Taxis won three per cent of tenders during this period. In this period the average number of operators bidding for a contract increased from [] in 2005 to [] in 2006 and [] in 2007.
17. However, Nexus expects the number of operators bidding for contracts to go down significantly in 2008, as four operators that submitted bids in the past have now been acquired by another operator or have exited the market. This means that following Go North East's acquisition of Stanley Taxis, it faces competition from four operators that have bid for contracts in the last three years (Stagecoach, Arriva, Veolia Transport and A-Line Coaches). All of these operators were awarded significantly fewer contracts than Go North East, although three of them are relatively large operators nationally.
18. On the basis of bidding data provided by Nexus, the OFT has analysed the constraint that is lost as a result of the acquisition of Stanley Taxis by Go North East. Excluding school services, Go North East and Stanley Taxis bid against each other for 33 contracts, which amounts to 11 per cent of the contracts awarded by Nexus from 2005 to 2007. When the operators that have ceased operating are ignored, Go North East and Stanley Taxis faced [] in bidding for [] of these contracts. For the remaining [] contracts (amounting to [0-10] per cent of all contracts awarded by Nexus in this period) Go North East and Stanley Taxis faced []. [Competition faced by Go North East and Stanley Taxis included competition from] one of the large, nationally active operators [and] an operator that was subsequently acquired by such an operator. The OFT considers that these competitors

are unlikely to cease operating. On the basis of this bidding data, the OFT considers that it is unlikely that the merger raises competition concerns in relation to services tendered by Nexus.

19. The OFT further notes that these [] contracts are for routes located within the catchment area of between two and four depots operated by Go North East's competitors. This is discussed further in the section on barriers to entry below, which considers whether the prospects and incentives for entry or expansion are sufficient to address any potential competition concerns arising from the merger.

Services tendered by Durham CC

20. Durham CC informed the OFT that it tenders all service contracts simultaneously once every five years. The most recent tender round took place in the second half of 2007, before the merger was completed. According to Durham CC, contracts were won by 21 operators, including the parties. Go North East and Stanley Taxis won 31 and six per cent respectively of the 84 contracts that were tendered. The average number of operators bidding for a contract was []. Contracts specifically in Derwentside, where Stanley Taxis was mainly active, attracted bids from [] operators, including the parties.
21. Despite the presence of a number of competing operators, Durham CC expressed concern about []. On the basis of bidding data from this round provided by Durham CC, the OFT cannot exclude that the merger may raise some competition concerns in this respect, although these would only extend to a very small share of the contracts awarded by Durham CC and would not arise until the next tender round in 2012.
22. The OFT notes that the contracts in question are for routes located within the catchment area of a number of depots operated by Go North East's competitors. This is discussed further in the section on barriers to entry below, which considers whether the prospects and incentives for entry or expansion are sufficient to address any potential competition concerns arising from the merger.

Commercial services

23. Go North East submitted that Stanley Taxis operated three commercial services, the FQ1, MC1 and MC2,⁵ and that its own services overlapped to some extent with all of these services. According to Go North East, on service FQ1, Stanley Taxis operated only three services per day in the early morning and late evening in order to move buses to and from tendered

⁵ According to Go North East, Stanley Taxis operated a fourth commercial service, the 711. This route was only around two miles long. It is included in the Stanley-Maiden Law flow referred to in paragraph 27 below.

routes and the number of passengers on this service was very small. For this reason the OFT has not considered service FQ1 further.

24. Stanley Taxis' main commercial services, the MC1 and MC2, ran from Lanchester and East Stanley respectively to Newcastle city centre via Stanley, Gateshead and MetroCentre. For part of their routes the MC1 and MC2 ran alongside each other. The OFT identified 23 flows on which these services overlapped with services operated by Go North East (most importantly services 43, 44, X30 and X31). This analysis was confirmed by Go North East.
25. In previous cases, the CC and the OFT assessed whether operators on a route provided effective competition based on the frequency of service.⁶ In these cases for 'frequent' services (that is, running at least once every 10 minutes) a competing service was considered to be effective if it ran with a frequency of no more than 10 minutes greater than the frequently running service.⁷ This is because passengers facing such a frequent service would be likely to wait at the bus stop for the next bus rather than refer to a timetable, and the extra time they would be willing to wait for a competing bus service would probably be limited. For 'less frequent' services a competing service was considered to be effective if it ran with a frequency no lower than half those of the more frequently running service.⁸ This is because passengers would be more likely to refer to a timetable to plan their journey and hence may find a longer gap between competing services acceptable.
26. Applying this methodology in this case, on three of the overlap flows Go North East operated more than 15 services per hour (on more than ten different routes), while Stanley Taxis operated only two services per hour.⁹ On eight overlap flows Go North East operated at least six services per hour (and eight to 11 peak-time services), while Stanley Taxis operated only one or two services per hour.¹⁰ On a further two overlap flows Go North East operated at least three services per hour (and up to five peak-time services), while Stanley Taxis operated only one service per hour.¹¹ This analysis shows that Stanley Taxis was not an effective competitor of Go North East on 13 out of the 23 overlap flows. Therefore, the OFT concludes that the merger does not give rise to competition concerns

⁶ See footnote 1, paragraph 19. See also the CC's report *Review of methodologies in transport inquiries*, May 2007, paragraph 26.

⁷ For example, if the frequently running service ran buses every five minutes, a competitor would need to run buses at least every 15 minutes to be considered effective.

⁸ For example, if the frequently running service ran four buses per hour, a competitor would need to run at least two buses per hour to be considered effective.

⁹ Newcastle-Redheugh Road, Redheugh Road-MetroCentre and Newcastle-MetroCentre.

¹⁰ Newcastle-Whickham Broadway, Newcastle-Spar/Pack Horse, Redheugh Road-Whickham Broadway, MetroCentre-Whickham Broadway, Redheugh Road-Spar/Pack Horse, Redheugh Road-Stanley, Newcastle-Stanley and AP New Durham Road-Stanley.

¹¹ Newcastle-AP New Durham Road and Redheugh Road-AP New Durham Road.

regarding these 13 flows. This conclusion is supported by the existence of effective competing operators on four of these 13 flows.

27. On the remaining 10 overlap flows Stanley Taxis' services ran frequently enough to make it an effective competitor of Go North East (albeit for four of these flows not during peak time).¹² On the basis of the limited evidence available to it, the OFT cannot conclude that these flows represent a sufficiently small proportion of the relevant routes that it would not be worthwhile for Go North East to change fares and frequencies for these routes.¹³ On these flows no effective competing operators were active and hence the merger has reduced the number of operators from two to one on these flows. On this basis, the OFT cannot exclude that the merger raises competition concerns on these flows and has therefore considered below whether the prospects for entry or expansion are sufficient to address any potential competition concerns arising from the merger.

Barriers to entry and expansion

28. While the geographic frame of reference is defined cautiously as individual flows, potential competition through the possibility of entry or expansion onto these flows by competing bus operators will be considered in the following section. In line with previous cases, the OFT has considered the extent of previous entry in the area, the significance of barriers to entry and of network effects, and the incentives and prospects for entry should Go North East, for example, increase fares or reduce frequencies following the merger.¹⁴

Previous entry and expansion

29. Information submitted by Go North East shows that in the past three years six additional operators entered to operate tendered services, three of which subsequently exited. The OFT notes that one of these entrants is a large national operator, Veolia. This information further shows that one new operator entered the area to operate commercial services and subsequently exited.
30. In addition, Go North East's competitors provided numerous examples where they entered a route operated by Go North East. This included some of the flows where Go North East and Stanley Taxis overlapped.

¹² Newcastle-Tantobie, Newcastle-Lanchester, MetroCentre-Spar/Pack Horse, MetroCentre-Tantobie, MetroCentre-Stanley, Spar/Pack Horse-Tantobie, Spar/Pack Horse-Stanley, Tantobie-Stanley, Stanley-Maiden Law and Stanley-Lanchester.

¹³ As suggested, for example, in the CC's report *Review of methodologies in transport inquiries*, May 2007, paragraph 26(a).

¹⁴ See, for example, the CC's report *Review of methodologies in transport inquiries*, May 2007, paragraphs 70-72, and the OFT's decision of 22 August 2007 regarding the anticipated acquisition by Arriva plc of the Darlington local bus service business of Stagecoach Group plc.

Extent of barriers to entry and expansion

31. Information provided by Go North East shows that the 'peak vehicle requirement' for the main commercial routes as they were operated by Stanley Taxis (MC1 and MC2) is only seven buses. Go North East noted that second-hand buses are freely available at low capital costs, including under rental agreements. According to one of the parties' competitors, for this number of buses it is not necessary to have a depot. Further, if a depot was used, the depot space required for this number of buses would in any case be limited and the cost of hiring a depot, as shown by information submitted by Go North East, would be relatively low. According to Go North East, barriers to entry for tendered services are lower due to the guaranteed revenue stream under the service contracts. Third parties confirmed that there are no significant barriers to entry for either commercial or tendered services to replicate the services that were operated by Stanley Taxis.
32. Further, the OFT considers that existing competitors already operating in the area where Stanley Taxis was active are capable of entering the relevant flows. Two of the parties' main competitors indicated that they keep changes to routes to a minimum, but one of these also noted that the only formal requirement for a change to a route is 56 days' notice to the Traffic Commissioner. Nexus and Durham CC stated that there are no capacity constraints or access restrictions for bus stations or public highways in their areas.

Network effects

33. Go North East has the largest network of services in the area where Stanley Taxis was active. Price differences between Go North East's single operator weekly tickets on the one hand and multi-operator tickets on the other hand may form a barrier to entry for an operator that enters on a small number of routes, because some passengers will need to connect between buses as part of their journey. However, the OFT also considers that any such disadvantage borne by a new entrant will be no greater than that borne by Stanley Taxis, which operated only two significant commercial routes (which also partly overlapped). In addition, smaller competitors that are already active in the area stated that they did not see a disadvantage in competing with larger operators with a wide network.
34. Further, the OFT does not believe that the merger will increase barriers to entry and expansion through an increase in the size of Go North East's network,¹⁵ as the increase in its size as a result of the acquisition of Stanley Taxis is very small (for example, in the area consisting of Derwentside, Gateshead, Sunderland and Newcastle Go North East operated 339 buses and Stanley Taxis operated only 13 buses).

¹⁵ Idem, paragraph 70.

35. In addition, the OFT has considered whether the threat of retaliation by the incumbent could form a significant barrier to entry in this case.¹⁶ Although one of Go North East's competitors expressed some concern about retaliation by Go North East, most competitors stated that they were not concerned by this and they provided numerous examples of where they entered a route operated by Go North East.

Incentives and prospects for entry

36. For bus operators there is a 'catchment area' surrounding their depots within which it is feasible to enter a commercial route or bid for a tendered service. Go North East and its competitors stated that the size of this catchment area is determined by the amount of 'dead mileage', which consists of the cost of getting from the depot to the start of the route and back.
37. In Tyne & Wear, Go North East faces significant competition from another large national operator, Stagecoach, and to a much smaller extent from Arriva, which is also a large national operator. In County Durham, Go North East faces strong competition from Arriva. Both Arriva and Stagecoach provided information that indicated that the main commercial routes operated by Stanley Taxis (MC1 and MC2) were within the catchment area of some of their depots. [] The most significant overlap flows in terms of passenger revenue are also located within the catchment area of other competitors' depots. Therefore, the OFT believes that there is potential for entry on all of the overlapping flows.
38. One local operator of tendered services indicated that it was looking to expand into operating commercial services around Stanley, where Stanley Taxis was based, and would consider entering the most significant overlap flows. Other competitors stated that they would consider entering if Go North East were to increase fares or reduce frequencies on the routes formerly operated by Stanley Taxis. The OFT has received evidence that shows that the inducement to entry may be high given the costs of entry and the profitability of these routes.

Conclusion on barriers to entry

39. Based on the factors set out above, the OFT believes that a number of Go North East's competitors that already operate in the area, including large national operators, have the ability [] to enter the overlap flows. One competitor indicated that it would consider entering the overlap flows, and others indicated that they would do so in the case of fare increases or frequency reductions. In addition, in view of the very limited scale of the services that were operated by Stanley Taxis, the OFT believes that the

¹⁶ Idem.

barriers to entry for a new operator to replicate these services are low, and are even lower for new operators bidding for tendered services.

THIRD PARTY VIEWS

40. Most of the parties' competitors did not express a concern about the merger, but one was concerned that the merger would result in a very strong position for Go North East in Derwentside. Further, the two parties' customers for tendered services, Nexus and Durham CC, expressed a concern that the merger would reduce the number of operators that can bid for its tendered services. These concerns are discussed above.

ASSESSMENT

41. The parties overlapped in the supply of commercial and tendered local bus services in an area consisting of Derwentside, Gateshead, Sunderland and Newcastle. In line with previous cases, the OFT has examined the merger with regard to, separately, services tendered by Nexus, services tendered by Durham CC and individual flows in commercial services.
42. The merger has resulted in a reduction in the number of operators that bid for services tendered by Nexus and Durham CC. As regards services tendered by Nexus, in the past three years the parties faced [] for the relatively limited number of contracts for which they bid against each other, but the number of operators competing for tendered services is relatively small. As regards services tendered by Durham CC, there are more operators competing for tendered services. However, Durham CC believed [], although this extended to only a relatively small number of contracts in Durham CC's recent tender round and the next tender round is not due to take place until 2012.
43. The OFT has identified 10 flows on commercial services on which Stanley Taxis was an effective competitor of Go North East and on which no other effective competitors were operating. Hence, the merger has reduced the number of operators on these flows from two to one.
44. Based on the evidence above, the OFT cannot exclude that the merger raises competition concerns in relation to tendered and commercial services. However, in the area in which Stanley Taxis was active, there are a number of competing operators, including large national operators, with depots that give them the ability [] to enter the overlap flows with a commercial service. Competitors have also indicated their willingness to enter. In addition, in view of the very limited scale of the services that were operated by Stanley Taxis, the OFT believes that the barriers to entry for a new operator to replicate these services are low, and are even lower for new operators bidding for tendered services.

45. The OFT considers that these findings on barriers to entry and expansion are sufficient to address any potential competition concerns arising from the reduction in the number of bidders for tendered services and from the two-to-one commercial service overlaps resulting from the merger.
46. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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