
Anticipated acquisition by Arriva plc of the Darlington local bus service business of Stagecoach Group plc

The OFT's decision on reference under section 33(1) given on 22 August 2007.
Full text of decision published 24 August 2007.

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

PARTIES

1. **Arriva Durham County Limited** is a wholly owned subsidiary of **Arriva plc** (Arriva). Arriva is one of the UK's largest bus companies with operations in various locations throughout the UK.
2. **The Darlington local bus service business of Stagecoach Group plc** (Stagecoach Darlington) operates entirely within the boundaries of the town of Darlington. Stagecoach Darlington comprises 28 buses, 78 personnel, a freehold bus depot and a leased drivers' rest room and operates on four urban commercial bus services and 17 tendered or contracted bus services. Stagecoach Darlington has an annual turnover of approximately £2.8 million and is part of **Stagecoach Group plc** (Stagecoach Group), an international public transportation group with operations in the UK, the USA and Canada.

TRANSACTION

3. Arriva has conditionally agreed to acquire the business (assets and goodwill) associated with Stagecoach Darlington from Cleveland Transit Limited and Busways Travel Services Limited, both wholly owned subsidiaries of Stagecoach Group. The OFT believes that the combination

of business and assets being acquired forms an 'enterprise' for the purposes of section 23(1) of the Enterprise Act 2002 (the Act).

4. The Office of Fair Trading's (OFT) administrative deadline for deciding whether to refer the merger to the Competition Commission (CC) is 22 August 2007.

JURISDICTION

5. As a result of this transaction Arriva and Stagecoach Darlington will cease to be distinct. The parties overlap in the supply of bus services in Darlington. Within the wider contiguous area comprising Darlington, Durham, Hartlepool and Stockton, which the OFT believes is a substantial part of the UK, the parties combined share of supply of bus services in that area is at least 37 per cent.¹ Therefore, the share of supply test in section 23 of the Act is met. 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 MARKET

Product market

6. Both parties are active in the supply of bus services, which can be segmented between commercial and tendered or contracted² services. It is usual for operators of commercial services to provide tendered services and, to a lesser extent, for operators of tendered services to provide commercial services. However, in past cases the OFT has taken the view that these two types of services have different characteristics and are not substitutes from a market definition standpoint.³ Tendered services are subsidised by the local authority in order to provide transport services where it would otherwise be unprofitable for private companies to do so.

¹ This is Arriva's share of supply based on passenger numbers. Its share of supply in the area based on concessionary fare reimbursement figures is 44 per cent. The OFT did not have access to Stagecoach Darlington's share of supply figures in the area.

² Tendered and contracted services have similar characteristics and will be hereinafter dealt with together.

³ OFT decision on the completed acquisition by Arriva plc of Premier Buses Limited, 1 June 2006.

Bus operators bid for tendered contracts, which are re-tendered every few years, and the local authority will, usually, specify the routes, the timing (or frequency) of services and the fares to be charged on those routes.

Competition in tendered services occurs at the bidding stage rather than in operating the service. The evidence before the OFT does not suggest that it would be appropriate to depart from this distinction in the present case.

7. The CC has previously considered the degree of substitutability between public and private transport and between different modes of public transport such as coach, train and tram.⁴ However, since this case does not raise competition concerns even on a narrow frame of reference (in other words, even if bus services are considered separately from private transport and from other modes of transport), it is not necessary to conclude on this issue.

Geographic market

8. As the overlapping activities of the merging parties are limited to the supply of bus services in the town of Darlington, the OFT will focus its competition assessment on that area.
9. When making a journey, passengers travel from a particular origin to a particular destination and therefore other origin/destination combinations are not likely to be substitutable from a demand-side perspective. The OFT and the CC have previously considered local markets in transport cases on the basis of the substitutability of competing services on point-to-point flows.⁵
10. Because the parties are the only two operators currently providing commercial bus services in Darlington, supply-side substitution is not readily available. For this reason, the constraint posed by other bus companies who might enter Darlington town will be considered in the barriers to entry section below.

⁴ CC report on the acquisition of the Scottish Passenger Rail franchise, June 2004.

⁵ CC report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited, June 2004; OFT decision on the anticipated acquisition by FirstGroup plc of the Greater Western Franchise, 30 September 2005. A flow is a bus journey between specific start and end points, which may be all or part of a longer bus route.

11. The OFT has focused its assessment on the impact of the merger on commercial bus services for a number of reasons. First, it is generally the case (and the OFT believes it is also the case in this merger) that entry is easier and more likely on tendered services than commercial services because once a new entrant has won a tender its minimum revenues are guaranteed for the duration of the tender period. Second, in this case there is currently an alternative provider, as well as a number of potential competitors, of tendered services in Darlington, while in commercial services the merger will create a monopoly. Therefore, the OFT considers that, if the merger does not raise competition concerns in the commercial services segment, it is unlikely that concerns would be found in relation to the tendered services segment. As the analysis below demonstrates, the OFT does not believe there is a reasonable prospect that the merger will lead to a substantial lessening of competition in commercial services. For this reason, the OFT does not consider that it is necessary to define the appropriate frame of reference against which to assess the impact of the merger on tendered services.

Conclusion

12. Therefore, the appropriate frame of reference for this merger is the supply of commercial bus services on each flow in which the parties overlap, which comprise the totality of commercial bus services in Darlington.

HORIZONTAL ISSUES

13. The parties are the only operators of commercial bus services in Darlington. Stagecoach Darlington operates four commercial and seventeen tendered bus services. Arriva operates six commercial urban services, seven tendered services, and nine commercial inter-urban services which come into Darlington. Arriva's turnover for commercial and tendered bus services in Darlington is roughly two and a half times as large as that of Stagecoach Darlington.
14. In summary, the merger will reduce the number of operators providing commercial services in Darlington from two to one, with a significant market share increment to Arriva.⁶ As a consequence, the merger will

⁶ In tendered services, the merger reduces the number of current players from three to two.

cause Arriva to be the sole supplier of bus services in all 21 flows in which the parties currently overlap.

Barriers to entry and expansion

15. As the CC pointed out in its '*Review of methodologies in transport enquiries*' report (the CC methodology report), the extent to which the parties could raise fares or reduce services on overlap flows or routes after the merger is subject to the prospects for entry and expansion of existing operators on those flows or routes.⁷ The paper also notes that a merger itself may also increase barriers to entry and expansion, for instance through the increase in the size of the network.

Arriva's submissions

16. Arriva submits that barriers to entry into the Darlington commercial bus services market are low, and says that a duly qualified operator can start or stop offering bus services merely by giving 56 days notice to the traffic commissioner. Arriva also submits that the capital resources required by a new operator are low, merely being the cost of renting older buses and having available sufficient funds and suitable maintenance proposals to ensure buses are safe to establish to the traffic commissioner that an 'O' [operator] Licence should be granted. Arriva also argues that in some previous cases the OFT concluded that existing operators with a local depot are unlikely to face significant barriers to expansion.
17. Arriva submits that there are a number of existing operators with depots within the surrounding area: there are 20 depots within 35 miles of Darlington that have over 20 'O' Licence disks, seven depots within 20 miles and three depots within 15 miles. The nearest depot is a Stagecoach depot that is not part of the acquisition and which is not subject to a non-compete clause.

Evidence of past entry and potential entry in the future

18. Only one third party told the OFT that it has entered the Darlington commercial services market in recent years. It has since withdrawn from

⁷ Competition Commission *Review of methodologies in transport inquiries* para 70.

the market, but stressed that this was due to circumstances unrelated to competition, and that entry was 'successful'. [redacted]

19. Of the third parties with depots 25 to 30 miles or more away cited by Arriva, many felt that they could not profitably serve Darlington from such distances. Of the four firms who said they would consider entering Darlington (see below), [redacted].
20. Four bus operators have told us that they would consider entering the Darlington commercial bus services market if Arriva increases prices or cuts services post merger. [redacted] stated that it already had firm plans to enter the market, submitting that it perceives Darlington as a profitable entry opportunity post merger and that it is willing to enter on a 'try it and see' basis. This also suggests that entry and exit costs are low in this particular case.
21. Another existing operator, who currently operates tendered services in Darlington and was cited by two other third parties as the most likely entrant, said that [redacted].

Re-entry by Stagecoach

22. Arriva submits that the acquisition does not involve a non-compete clause and that therefore Stagecoach could simply re-enter the market from one or more its existing depots close to Darlington. However, in view of the fact that Stagecoach is exiting the Darlington market it cannot be considered a credible potential entrant.

Local network effects

23. The merger will increase the size of Arriva's network in Darlington and as such may increase barriers to entry to the extent that network effects are important. Price differences between single operator weekly tickets and multi-operator weekly tickets (£6.50 for the former against £8.00 for the latter) suggests that it might be difficult for a company to enter on only one or a small number of routes because some consumers need to connect between buses as part of their journey.
24. However, based on data provided by Arriva, the OFT considers the number of those requiring more than one bus to complete their journey is low,

which indicates that local network effects are not an aspect of the market that will deter entry. Indeed, none of the third parties who would consider entering the Darlington commercial bus services market mentioned local network effects as a barrier to entry.

Wider network effects

25. In the CC methodology report it is noted that 'the greatest barriers to entry or expansion for bus service operators are the threat of retaliation by the incumbent and the significant costs associated with entry on a network basis'.⁸ Arriva has a large network of buses in the UK, and the potential entrants identified by the OFT's third party survey are much smaller than Arriva.
26. However, in contrast to previous cases considered by both the OFT and the CC,⁹ in this case of the four potential entrants in Darlington, three did not raise concerns about retaliation by Arriva following entry. The one company who did raise concerns of this kind did not say these would prevent or deter it from entering. Another third party who did not consider itself a potential entrant said that Arriva in Darlington did not have the same reputation for retaliating against new entrants as large bus companies elsewhere may have.
27. In view of all of the above, the OFT believes, on the basis of the available evidence in this particular case, that barriers to entry and expansion in this particular case are low and that entry would be timely, likely and sufficient to deter any attempt by Arriva to exploit the reduction in rivalry flowing from the merger.

THIRD PARTY VIEWS

28. The OFT received comments from four individual consumers, of which only one was concerned about the anti-competitive effects of the anticipated merger. These concerns have been dealt with above.

⁸ Para 72.

⁹ See for example the OFT decision on the anticipated acquisition by Arriva plc of the assets of the Hertfordshire bus operations of Sovereign Bus and Coach Company Ltd, 3 August 2004 and the CC decision on Stagecoach and Scottish Citylink: A report on the completed joint venture between Stagecoach Bus Holdings Limited and Braddell plc in relation to megabus.com, Motorvator and Scottish Citylink, 23 October 2006.

29. In commenting on the anticipated merger, Darlington Borough Council is generally unconcerned, in particular in view of the memorandum of understanding that it has signed with Arriva in order to ensure the quality of services does not deteriorate post merger.
30. No third party bus companies operating in the wider area around Darlington stated to the OFT they were concerned about the merger.

ASSESSMENT

31. The parties overlap in the provision of commercial local bus services and tendered local bus services in Darlington town, and the merger would result in Arriva becoming the sole operator of commercial bus services in that area. On a flow-by-flow basis, the merger would reduce the number of competitors in commercial bus services in Darlington town from two to one on 21 flows.
32. However, the OFT believes that barriers to entry and expansion in this particular case are sufficiently low to deter or defeat any attempts by the merged entity to capitalise on the loss of rivalry brought about by the merger. In particular, four firms submitted that they would consider entering the market if the merger were to lead to a change in competitive conditions. Of these, [redacted].
33. Consequently, the OFT does not believe 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.

DECISION

34. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.