OFFICE OF FAIR TRADING

Anticipated acquisition by SvitzerWijsmuller A/S of Adsteam Marine Limited

The OFT's decision on reference under section 33(1) given on 31 August 2006. Full text of decision published 8 September 2006.

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

PARTIES

1. **SvitzerWijsmuller A/S** ('Svitzer'), a wholly owned subsidiary of A.P. Møller – Mærsk A/S, is a Danish marine services company. It is active in harbour, ocean and terminal towage, salvage, emergency response and rescue, and crew boat services. Svitzer is a subsidiary of A.P. Moller-Maersk Group. Svitzer is active in the UK through its subsidiaries Svitzer Marine Limited and Tyne Towage Marine Limited.

2. **Adsteam Marine Limited** ('Adsteam') is an Australian company and a provider of harbour towage, terminal towage, salvage and agency services around the world. It is the parent company of Adsteam UK Limited which operates in the UK with a turnover in the last financial year of some £46 million.

TRANSACTION

3. Svitzer intends to acquire shares in Adsteam by way of a public bid. The offer is subject to approval by the OFT and the offer closes on 29 September 2006, unless extended.

4. The OFT's administrative deadline for deciding whether to refer the merger to the Competition Commission is 31 August 2006.

JURISDICTION

5. As a result of this transaction Svitzer and Adsteam will cease to be distinct. The parties overlap in the supply of harbour towage services in the UK, and their combined share of supply of harbour towage services in the UK is [80-90 per cent]. Consequently, 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

6. The parties are tug boat operators and in the UK they overlap in the provision of harbour towage, terminal towage and dry salvage services.

Product scope

Harbour towage

7. Harbour towage is the precise manoeuvring, positioning, safe berthing and unberthing and passage through narrow waterways of large vessels in a port area.

8. It may be possible to segment harbour towage services by whether the port serves deep sea or short sea vessels as the requirement by some shipping lines for a deep sea port will constrain their ability to switch between ports.

9. Segmentation may also be possible by the type of cargo being transported (e.g. dry bulk, liquid bulk, containers or cars). Vessels transporting bulk cargoes may be less able to switch ports than container or car liners because these ships require deep sea ports which have developed bulk-handling facilities and have the appropriate inland infrastructure (e.g. railheads or proximity to a primary road network).

10. However, there is no distinction between the types of tugs required for vessels carrying different types of cargo or serving different types of port and therefore the OFT has considered harbour towage services without segmentation.

Terminal towage

11. Terminal towage involves the provision of safety and marine support to terminals, including berthing support, pilotage, escorting, mooring, safety and environmental services.

12. In the UK there are eleven 'owner terminals', where the towage operator is contracted directly with the terminal, and four 'customer terminals', where the towage operator contracts with the ship owner who transports the relevant commodity to or from the terminal.

13. Owner terminal towage contracts are typically let by specialist companies (usually liquefied natural gas or oil terminals), for long periods (up to 25 years) and are won by a single towage operator. There is little, if any, demand side substitution either to other terminals or to harbour facilities.

14. Customer terminals are typified by shorter but staggered contracts and each terminal is used by several ship owners. There is only a small number of customer terminals in the UK. The structure of contracts at customer terminals is similar to those in the harbour towage market: at some port areas customer terminals are treated as part of the total pool of harbour towage contracts, and in one other harbour towage work is minimal it is undertaken by the neighbouring terminal towage operator on an ad hoc basis. For this reason, the considerations below in relation to the geographic scope of the harbour towage market are also applicable to the supply of customer terminal towage services.

15. The OFT is aware of some supply side substitution (on a small scale) between tugs used for owner terminals and harbour towage. The tugs are similar and therefore in the medium term it may be possible to substitute tugs on a more permanent basis. However, because tugs are usually bound to contracts, limiting the degree of substitution at least in the short term, a conservative approach is taken and these two services are considered separately.

Salvage

16. Salvage involves attending to a ship at risk at sea and providing appropriate assistance to preserve the environment and the economic value of the vessel and its cargo. The salvage sector is generally divided into two segments, which are considered as distinct frame of references due to the different ways in which the service is contracted:

- dry salvage – recovery of vessels experiencing problems but are still afloat (these are usually time-critical), and

- wet salvage – recovery of sunken vessels (these are usually less time-critical unless there is an environmental issue such as an oil spill).

17. The parties do not overlap in wet salvage and this segment is not considered any further.

18. Dry salvage requires a high level of specialist equipment and therefore the substitutability of tugs used for salvage work for harbour or terminal tugs is low. However, as all harbour and towage tugs have basic fire-fighting equipment they are often used as first response vessels in emergencies. Two salvage customers suggested that terminal and harbour tugs may be able to undertake the whole of some simple salvage operations.

19. The most closely located harbour and terminal tugs have a clear role in providing the first emergency response. Whilst there is clearly no demand side substitution, salvage work appears to be part of the use, albeit infrequently, of harbour and terminal tugs.

20. The OFT has not concluded on the product scope for salvage work as the competition assessment is the same regardless of the approach adopted.

Geographic scope

Harbour towage

21. Demand for harbour towage, and therefore the geographic scope of harbour towage, is derived from the demand by shipping companies for port services. The parties assert that the appropriate scope is the individual port area[1] and, although limited supply and demand side substitution supports this, the OFT has not been able to obtain sufficient pricing data to conclude on the geographic scope of the frame of reference. There are a number of pricing elements, such as the ability by customers to negotiate prices and obtain discounts, suggesting that the parties are subject to competitive constraints arising from outside each port area - these will be dealt with below. Therefore, there are arguments that the geographic scope is wider than each individual port area. As a consequence, the impact of the merger is considered both at local (individual port areas) and national (UK-

[1] An ancillary dock may be included in the 'port area' together with the main port or ports where the particular ancillary dock is governed by the same Port Authority as the main port or ports, or if there is insufficient demand at the ancillary dock to support a dedicated harbour towage operator, or both. While some port areas include only the main port (e.g. in the Aberdeen port area only the port of Aberdeen is included), others encompass a number of ancillary docks and harbours (e.g. the Tees port area includes Billingham, Blyth, Hartlepool, Middlesbrough, Redcar and Teesport).

wide) levels. As noted above, the considerations in relation to the geographic scope of the harbour towage market are also applicable to the supply of customer terminal towage services.

Terminal towage

22. Owner terminal towage contracts are tendered for at an international level. This is supported by third party comments and by bidding data provided by the parties. No third parties suggested the market for owner terminal towage was narrower than global.

Salvage

23. The parties consider that the appropriate geographic scope for dry salvage is worldwide because vessels operate on a global basis and salvage services may be needed anywhere in the world. Following the salvage operation, payment for emergency response vessels is determined by arbitration following completion of the rescue operation. The OFT understands that this is done on a national level.

24. In this case, the OFT has not found it necessary to conclude on the geographic scope for salvage operations.

HORIZONTAL ISSUES

Harbour towage

Loss of actual competition

25. Analysis undertaken on an individual port area basis shows that the only overlap between the parties is in Liverpool, where the proposed transaction is a merger to monopoly (currently Adsteam's share of supply of harbour towage services in Liverpool is approximately [60-70] per cent and Svitzer's is approximately [30-40] per cent).

26. All customers in Liverpool that responded to the OFT are concerned about the proposed merger. In summary, they believe that the parties actively compete with each other and that the merger will lead to a substantial lessening of competition and, as a result, an increase in prices above the competitive level within the Liverpool port area. A number of customers have specifically mentioned that they were able to achieve better deals by playing Svitzer and Adsteam off against each other. This is confirmed by the parties, who submitted that customers have used the threat of switching towage operator to negotiate lower prices and provided an

example of this happening in the past, and by a number of examples given by third parties.

27. Figures provided by the parties suggest that average revenue per tug between 2003 and 2005 was around [ ] per cent lower in Liverpool than the average for each party across the other UK ports in which they operate, perhaps indicating fiercer competition in Liverpool.

28. The parties presented a study by the Australian Productivity Commission[2] which found that it would be necessary for a port area to have at least 8,000 tug jobs per year to make it profitable to have two harbour towage operators in one area. The only port area in the UK where there are more than 8,000 tug jobs a year is the Humber, which, according to the parties, is currently the only port area in the UK where two towage companies operate profitably; in Liverpool there are around [ ] tug jobs per year. Based on these data, the parties have argued that the Liverpool port area cannot sustain two high-cost operators, and that because activities at that port area are becoming increasingly loss-making, it could become a single-operator port even in the absence of the merger.[3] However, the OFT has not been provided with any evidence to support this statement[4] or to demonstrate that the business is unsustainable.

29. It also seems that the effects of competition in Liverpool are spread to other ports in which the parties operate. Customers using the Liverpool port and other UK ports commented that competition in Liverpool helps them achieve better prices in ports in which one of the parties is the sole operator, in particular via multi-port contracts and by benchmarking prices and discounts given by Svitzer against those given by Adsteam; these beneficial effects would be lost with the merger.

30. The merging parties claimed that the merger would lead to efficiencies at the Liverpool port area that could counter-balance any lessening of competition. However, no evidence or arguments were provided to demonstrate that such efficiencies would be passed on after the merger in the form of benefits to customers.

31. The OFT therefore believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition in the supply of harbour towage services in the port area of Liverpool.

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[2] 'Economic Regulation of Harbour Towage' 2002.
[3] It is worth pointing out that the parties did not claim the 'failing firm defence'.
[4] [ ].

Loss of potential competition

32. On a UK wide basis, the parties' combined share of supply of harbour towage services by number of tug jobs is around [80-90] per cent (increment [20-30] per cent). Furthermore, apart from Targe Towing, which operates in Aberdeen and Dundee, all other tug operators only operate in a single port area, whereas the parties combined operate in 13 port areas (one overlap in Liverpool) out of the total 25 port areas across the UK.

33. The merging parties argue that they are subject to competitive constraints deriving from potential competition outside of individual port areas and not confined to each other. This statement is supported by evidence from the parties showing that customers have at least some scope for negotiating prices even in ports where the parties are the sole service provider. It is also corroborated by almost all customers who submitted that they have some level of bargaining power, even outside of Liverpool, which they fear would be lost with the proposed merger. There is also some evidence of nationwide competitive dynamics, since price negotiations and reductions against published tariffs are achieved regardless of proximity to a competitor port. Finally, evidence presented to the OFT suggests that customers of harbour towage services in the UK are not looking to switch ports. This indicates on a prima facie basis that unconstrained monopoly prices are not being charged in these ports but rather are being constrained, at least to some extent, by factors from outside of the individual ports.

34. Hence, it is necessary to consider whether the merger will result in a loss of potential competition for UK harbour towage services, and, if that is the case, whether a reduction in potential competition will lead to a substantial lessening of competition. It is therefore necessary to identify the source of such potential competition.

Customers switching ports

35. A limited number of customers told the OFT that, if harbour towage prices went up by a small but significant non-transitory amount, they may be willing to move to different ports if towage prices were lower elsewhere.

36. The threat of switching ports seems to be more credible in relation to customers transporting cars and containers. A number of third parties suggested that competition among ports capable of accepting containers and cars liners for these customers is much stronger than for transporters of bulk goods, who, at least in the short term, are more tied to the 'home' port through port-specific investments and existing inland infrastructure. This could be the explanation for the fact that

customers transporting cars and containers in general obtain much higher discounts than customers transporting bulk goods, although the parties argue that the reason for these higher discounts is related to collective purchasing practices and inherited prices.

37. After the proposed merger Svitzer would be the sole harbour towage operator in the majority of UK ports with harbour towage services (indeed, Svitzer would operate at all the major UK liner ports and at 14 of the 15 largest individual ports in terms of UK trade and in all of the top ten ports through which vehicles are transported and the top seven ports through which containers are transported), and therefore the potential to credibly threaten to switch ports would be considerably reduced.

38. However, it is not clear from the evidence received by the OFT that the threat of customers switching ports in case harbour towage prices go up is credible enough to, in itself, constrain the behaviour of the parties. There is a considerable discrepancy between the information provided by third parties and the merging parties in relation to the proportion of towage costs to overall docking costs. The parties originally submitted that towage costs correspond to 15-27 per cent of total port calling costs but later claimed that for container traffic could account for as little as 2 per cent of total calling costs. Third parties gave a range of responses, but the majority of customers claim they are 30-40 per cent of total port costs. The proportion of harbour towage costs in relation to overall port calling costs clearly has an effect on the incentives that different customers have to switch ports in the event of an increase in prices of harbour towage services. The OFT did not find any past examples of customers switching ports due to an increase in towage prices and, although the incentive to switch will vary between ports and shipping companies, the majority of customers submitted that they would not switch in the event of a price increase. In addition, a number of other considerations would be taken into account by customers before they decide to switch ports, such as geographic closeness to factories or storage facilities (particularly to those dealing with dry and liquid bulk cargo) and road haulage costs.

39. Furthermore, it is possible that the threat from a Port User Group, Port Authority or large customer to support a new entrant into the port area would happen before a price rise significant enough to induce switching ports could occur. An example of this happening is when the [ ] Port User Association threatened to invite in a new towage operator in response to a [ ] per cent increase in towage prices.

40. It might be the case that an increase in harbour towage costs would cause some customers to switch part of their business, but not all of it, to a different port area, but the OFT does not have any evidence that this is the case nor can it quantify what the diversion ratio would be.

41. Therefore, it seems that although the threat of switching ports might impose some constraint on the behaviour of the merging parties, it is not a particularly strong one.

Entry

42. Barriers to entry in the provision of harbour towage services are high. There has been almost no supply side entry (outside of acquisition) in the past decade.[5] Almost all UK ports can only support one tug operator (because of the economies of scale involved) which therefore makes demand side substitution impossible without switching ports (which would require a re-assessment of a range of costs) and implies that new entry requires the displacement of the incumbent supplier.

43. Contracts between tug operators and shipping companies are staggered and as a consequence a potential entrant may find it difficult and time consuming to win a viable number of customers to make entry feasible. Adsteam employs multi-port agreements with a number of its customers, which may create further difficulties for potential supply side entrants.

44. While supply side entry from a tug operator acting alone would be extremely difficult, it could, arguably, be possible if it was sponsored by shipping companies or a port authority. Almost half of the harbour customers that responded to the OFT said they would consider supporting a new entrant if they thought it would be financially viable. In fact, SMS' entry in the Humber was a result of a dissatisfied shipping company facilitating its entry. Another entrant, West Coast Towage in Newport, was supported by the Association of British Ports (ABP), but it was eventually acquired by Svitzer.

45. Nonetheless, although barriers to entry into the supply of harbour towage services are high the parties contend that they are constrained in their behaviour by the threat of entry by low cost operators. The OFT believes that the parties can set its prices over time in such a way as to reduce the incentives of rivals to enter the port areas in which the parties currently operate. However, there is some

[5] The OFT knows of two instances of entry – SMS in the Humber in 2001 and West Coast Towage (WCT) in Newport in 1993. WCT did not have enough capacity to provide a comprehensive terminal and harbour towage service and was eventually acquired by Svitzer in 2001.

disagreement on whether the most likely entrants are low-cost operators or the parties themselves.

46. The OFT accepts that the likelihood of new entry into a port materialising is not very high (indeed, it has not happened in the last decade apart from SMS in Humber). However, it may be the case that if entry does happen the impact on the parties activities is so high that the risk, even small, is sufficient to constraint the parties' behaviour.

Threat of entry by a low cost operator

47. An important element of the parties' argument is that in the UK there are two distinct tug operator types: one type, like the parties, is highly unionised, with high operating costs (crew wages and other benefits such as pension plans). The other, like SMS (a recent entrant in the Humber), is non-unionised and therefore have lower operating costs. The parties estimate that non-unionised operators have crew costs [ ] per cent lower than unionised operators. Adsteam itself has very recently introduced a low cost harbour towage operator in the Humber to compete with SMS.

48. The merging parties contend they are constrained in their behaviour by the threat of port authorities or customers inviting or supporting a new low cost entrant such as Boluda, HKTS, Kotug, PSA Marine and SMIT (all of which operate worldwide) to operate in the relevant port.[6] The parties consider that these international operators have the requisite reputation and service credibility and a history of competitive pricing.

49. However, the OFT did not receive any evidence that any of these towage companies have considered entering the UK harbour towage market, even though there are examples of their successful entry into other worldwide ports in the recent past. None of the third parties that responded to the OFT mentioned low cost operators as an alternative towage services supplier. In addition, the parties provided little documentary evidence that their commercial decisions are influenced by the threat of entry by low cost operators, and the OFT was not persuaded that this is the case.

50. Another factor that might lower the credibility of entry by operators (low cost or otherwise) other than the parties themselves is the ability of the parties to offer multi-port arrangements or other fidelity-inducing pricing techniques since several

shipping lines operate at more than one UK port.[7] A new entrant could, in principle, overcome this by entering at more than one UK port, but, on the evidence before the OFT, in reality the number of contracts required in order to do so - due to the staggered nature of the contracts and the need to have a minimum number of tug boats in order to make entry viable - make it very unlikely. Another way of overcoming this obstacle would be to offer multi-port arrangements involving ports across the globe; however, the OFT does not have information on the contracts that shipping liners calling at UK ports have with potential entrants operating abroad and therefore it is not able to assess whether these international multi-port agreements are likely to happen in such a scale to offset the barriers to entry created by multi-port agreements in the UK.

51. One additional possible explanation for the fact that low cost entry has not occurred in the UK apart from the Humber is related to the fact that entering a port which is only able to sustain one operator involves displacing the incumbent supplier: the displacement of a unionised operator by a non-unionised could generate significant industrial action, whereas substitution of a unionised incumbent by a unionised entrant would not.

52. Finally, the parties estimate that the minimum efficient scale for low cost operators is two thirds of that of a unionised supplier such as the merging parties. If a non-unionised operator could potentially offer prices significantly lower than the incumbent unionised provider, it is not clear why low cost entry has not happened in the past (apart from SMS entering the Humber, a port area which can sustain two operators). Irrespective of some of the supportive arguments discussed above, the balance of evidence suggests that the credibility of the threat posed by low cost operators is not so high.

Threat of entry by the merging parties

53. There are a number of factors to suggest that the strongest threat of entry into Svitzer's and Adsteam's port areas comes from each other.

54. First, the vast majority of customers suggested that this is the case. Even though a number of customers transport goods into and out of the UK and therefore are likely to be aware of alternative international towage operators that could start

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[6] In addition, the parties told the OFT that some customers could organise their own towage if need be. A car company threatened this once during negotiations but the threat did not materialise.

[7] [ ]. This would have an impact on the level of barriers to entry into the market regardless of whether or not such practices are considered legal under the Competition Act 1998 and/or Article 82 of the Treaty of Rome.

supplying the UK market, no harbour towage customers mentioned a low cost supplier as a credible potential entrant.

55. The reasons cited by customers to explain why they perceive the merging parties as being the most likely entrants into each other's port areas are, first, that Svitzer and Adsteam are the only UK players with a national presence. Second, no other competitor currently operating in the UK is large enough (in terms of sustaining short-term losses when entering a port and before displacing the incumbent) to provide a similar constraint on the parties. Third, the vast majority of third parties believe that the credibility of a new entrant not currently connected to a UK port is low because, to enter a UK port, a new entrant would need contracts of sufficient value to make the investment financially viable, which would be difficult to achieve given the staggered nature of contracts. Fourth, customers suggested that entry by a towage company that does not already operate in a number of UK ports is likely to be hindered by the possibility of multi-port arrangements being implemented. Finally, sponsored entry, while not impossible, has only been successful on one occasion and that was in the Humber, where the parties state that there is sufficient business to support two tug operators in the long term (and therefore entry did not involve displacement of the incumbent operator).

56. The parties reject the notion that they are likely to enter each other's ports; indeed, the parties have never entered each other's ports in the UK. They submitted that their cost bases were very similar (due to the very high unionisation of their workforces) and therefore are not able to offer substantial price benefits to customers relative to each other.[8]

Conclusion

57. Even if it is the case that low-cost suppliers could also enter the UK harbour towage market, the merger causes the loss of a major potential entrant, with not only an established reputation in the UK but also a national presence both in terms of share of supply ([60-70] per cent) and number of ports areas covered (six), in particular in a context in which the next competitor has a share of supply of [0-5] per cent and is only active in two port areas.

58. Although there are some inconsistencies in the arguments brought forward by third parties, they consistently identify the merging parties as each other's closest competitors. The balance of evidence, in particular that there has not been any

[8] The parties told the OFT that the two main costs that high unionisation brings are higher direct wages and higher pension liabilities (legacy costs).

low-cost entry apart from in the Humber (which can sustain two operators) even though low-cost operators could possibly offer significantly lower prices in view of their lower cost base, and that there seem to be very little sponsored entry, leads the OFT to believe that the threat of entry by the parties into each other's markets is a more important constraint on the merging parties' behaviour than the threat of entry by low cost operators.

59. In view of all of the above, the OFT believes that it is or may be the case that the loss of potential competition caused by the merger may be expected to result in a substantial lessening of competition in the supply of harbour towage services in the UK.

Terminal towage

60. Svitzer is the largest terminal towage operator in the world. The parties' combined global market share in terminal towage is around [10-20] per cent, but the increment is minimal (less than 1 per cent). Bidding data suggest that the parties are not particularly close competitors: of the 20 global tenders lost by Svitzer in the last five years, only [ ] were won by Adsteam. Following the merger there will still be several large global competitors. There were no third party concerns relating to terminal towage.

61. In view of the evidence before it, the OFT does not believe it is or may be the case that the proposed merger may be expected to result in a substantial lessening in competition in owner terminal towage services.

62. In relation to customer terminal towage services, there are a number of elements to suggest that its competitive dynamics are very similar to those found in the harbour towage sector. On the other hand, the OFT did not receive any third party concerns in relation to customer terminal services. However, given that the reference test is met with respect to harbour towage services, the OFT does not need to reach a conclusion on whether it is or may be the case that the proposed merger may be expected to result in a substantial lessening in competition in customer terminal towage services.

Dry salvage

63. The parties' combined global share of dry salvage jobs in 2005 was [20-30] per cent (increment [0-5] per cent).

64. As discussed above, terminal and harbour towage vessels may be used as first response vessels in dry salvage operations, which could provide leverage in terms

of winning the contract for the whole salvage operation. However, first response vessels tend to be a 'situational monopolist' for each individual salvage operation and therefore incentives regarding pricing will not change post merger. Moreover, the price for dry salvage work is set by an independent arbitrator.

65. All third parties that responded to the OFT are unconcerned about the impact of the merger on the salvage market, in particular due to the protection they are given through the existence of a standard arbitration process to set prices. In addition, third parties mentioned other credible competitors that are capable of conducting complex salvage jobs.

66. The OFT therefore does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening in competition in dry salvage services.

VERTICAL ISSUES

67. Due to the fact that Svitzer is controlled by A.P. Moller Maersk, who also owns the Maersk Line shipping company, several third parties have raised concerns that following the merger Svitzer may give preferential treatment to Maersk Line's vessels in detriment to the quality of service offered to other customers as post merger Maersk will be using ports where Svitzer operates.

68. However, it seems that the relevant port authority organises the traffic within each port and the tug operator cannot influence this. Therefore, the OFT does not consider that a competition issues arises from the vertical relationship between Svitzer and Maersk in this case.

THIRD PARTY VIEWS

69. The vast majority of harbour towage customers contacted by the OFT expressed concerns about the proposed merger, which have been referred to above. Most comments were consistent among each other and provided a good insight into the dynamics of the markets in question. No concerns were raised in relation to terminal towage, and only one third party was concerned about the effects of the proposed merger on salvage work, which has also been dealt with above.

ASSESSMENT

70. 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 in salvage or owner terminal towage services. Given that the reference test is met with respect to

harbour towage services (see below), the OFT does not need to reach a conclusion on whether it is or may be the case that the proposed merger may be expected to result in a substantial lessening in competition in customer terminal towage services.

71. The merging parties argue that the geographic scope of harbour towage services is each individual port area, which is supported by low supply and demand side substitution. However, the limited pricing data available, combined with evidence that the parties are subject to competitive constraints arising from outside each port area, suggest that the appropriate geographic scope may be wider than each individual port area.

72. The only port area where the parties overlap is Liverpool, where the merger will result in a reduction in the number of competitors from two to one. All customers using Liverpool port area that responded to the OFT are concerned about the proposed merger as they believe that Svitzer and Adsteam actively compete with each other in that port area and that the merger will lead to a substantial lessening of competition and, as a result, an increase in prices above the competitive level within the Liverpool port area. In addition, competition in Liverpool has spillover effects across the country as customer comments suggest that it helps them achieve better prices in ports in which one of the parties is the sole operator.

73. The parties questioned whether having two towage operators in Liverpool was the proper counterfactual since they argued that Liverpool would become a single-operator port even in the absence of the merger. However, based on the evidence before it, the OFT was not convinced that the proper counterfactual should be changed from the current situation of the Liverpool port area having two towage operators as it did not receive any evidence to support this arguments nor to demonstrate that business is unsustainable if there are two harbour towage operators in the Liverpool port area. If one of the parties were to exit Liverpool, this would potentially open up more contracts for a new entrant to contest than would the elimination of that firm through merger.

74. Taking the UK as a whole, the proposed transaction brings together the largest and the second largest towage operators with a combined share of supply of [80-90 per cent] per cent. The next largest operator undertakes [0-5] per cent of UK tug jobs and there is only one other tug operator who operates in more than one UK port (it operates in two).

75. Barriers to entry into harbour towage services are high and there has been extremely limited entry in recent history. Most UK ports can only sustain one tug operator (due to the substantial economies of scale required) and therefore entry

requires displacement of the incumbent operator. In addition, contracts with customers are staggered which forms a barrier to some extent to achieving a minimum efficient scale. Finally, it is possible for companies operating in a number of ports to implement fidelity-inducing pricing arrangements, such as multi-port arrangements similar to the ones operated by Adsteam, which may increase barriers to entry.

76. In spite of the high barriers to entry, the merging parties are constrained in their behaviour by the threat of entry of a new competitor into a port area. One of the reasons for this may be that, although the likelihood of a threat of entry into a port materialising is not very high, the impact it would have in case it does happen is so high that it is sufficient to constraint the parties' behaviour.

77. However, while the parties contend that the most likely new entrants are low cost, non-unionised operators, there are a number of reasons that lead the OFT to believe that the strongest threat of entry into each other's areas comes from the parties themselves.

78. First, the history of entry by low-cost operators is extremely limited. Second, no third parties identified low-cost operators as likely entrants into this market, even though a number of customers transport goods in and out of the UK and therefore are aware of alternative towage operators who could enter the UK market. Third, parties provided little documentary evidence that their commercial decisions are influenced by the threat of entry by low-cost operators, and the OFT was not persuaded that this is the case. Fourth, the parties are active in a large number of UK ports and therefore are capable of offering multi-port arrangements, which may cause barriers to entry to new entrants to be higher than they are for the merging parties. Fifth, the parties estimate that the minimum efficient scale for low cost (non-unionised) harbour towage operators is [ ] of that of a unionised supplier such as Svitzer and Adsteam; the fact that low-cost entry has not happened in the past (apart from in the Humber, where barriers to entry are lower due to its ability to sustain two operator) is an indication that the credibility of the threat posed by low cost operators is not high. Finally, even if low-cost suppliers could also enter the UK market, the merger in any case causes the loss of a major potential entrant already with reputation in the UK.

79. An important element in this case is the scale and strength of customer comments, the vast majority of which expressed consistent concerns about the proposed merger. The merging parties provided plausible arguments as to why competition concerns may not arise as a result of the merger. However, in view of the high market shares and barriers to entry, the substantial customer concerns and the lack of documentary evidence from the merging parties to support their

claims, the OFT has decided that it is or may be the case that the merger may be expected to result in a substantial lessening of competition in the supply of harbour towage services in the Liverpool port area and in the UK generally.

UNDERTAKINGS IN LIEU

80. Where the duty to make a reference under section 33(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted, or may result, from it.

81. The OFT's 'Mergers – substantive assessment guidance' states that undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut.[9]

82. Svitzer offered the following undertakings. [ ]. In addition to each of these options, [ ].

83. While very much welcoming the willingness of the parties to put forward structural remedies, the OFT does not consider that these offers are capable of maintaining the competitive dynamic in the supply of harbour towage services and remove the risk of a substantial lessening of competition arising.

84. [ ]. The widest structural undertaking offered ([ ]) would not restore the pre-merger competition dynamics: the new entrant would have a market share of around [ ] per cent, which is less than the increment that the merger will cause ([20-30] per cent), and would operate in a significantly smaller number of ports than the number in which Svitzer and Adsteam currently operate. While this divestment could be enough to protect marginal customers, it would not guard infra-marginal ones.

85. In any event, in this case, whilst the OFT has concluded that competition concerns do arise from a loss of potential competition resulting from the merger, triggering its duty to refer, it has not been possible to quantify the precise magnitude of this loss of potential competition at first phase. The OFT therefore considers that the extent of the competition concerns raised by the merger and

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[9] Paragraphs 8.3-8.4.

the undertakings offered by Svitzer are not clear cut, and the duty to refer remains.

Conclusion

86. 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.

DECISION

87. This merger will therefore be referred to the Competition Commission under section 33(1) of the Act.