OFFICE OF FAIR TRADING

Completed joint venture between Stagecoach Bus Holdings Limited and Braddell plc in relation to Megabus.com, Motorvator and Scottish Citylink brands

The OFT's decision on reference under section 33(1) given on 15 March 2006. Full text of decision published 19 April 2006.

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

PARTIES

1. **Stagecoach Group plc (Stagecoach)** is an international transportation group with operations in the UK, USA, Canada and New Zealand. [See endnote 1] It is a UK listed company. Stagecoach's UK bus division – Stagecoach Bus Holdings Limited (Stagecoach Bus) – comprises 17 regional companies that provide local and regional bus transport services. In 2003, Stagecoach launched megabus.com, offering 'long distance' intercity coach services. It acquired the Motorvator coach service brand, operating between Glasgow and Edinburgh, in 2004.

2. Stagecoach is also active in the rail sector, and it currently operates two wholly-owned franchises – South West Trains and Island Line. It also operates the Sheffield Supertram system. In addition, Stagecoach holds a 49 per cent interest in Virgin Rail Group Holdings Limited, which operates the Virgin Cross Country and West Coast Mainline rail franchises. In its submission Stagecoach asserts that it does not have operational control over these franchises.

3. **Comfort DelGro Corporation Limited (Comfort DelGro)** is a Singapore based transport company, with operations in Singapore, China, the UK, Ireland, Australia, Vietnam and Malaysia. It is the ultimate parent company of Metroline (which operates bus and coach services in London) and is the owner of a number of subsidiaries which operate Computer Cab in London, Comcab in Scotland and GEM High Enterprises (a taxi

company) in Aberdeen. Prior to the joint venture, Comfort DelGro was the sole owner of **Scottish CityLink Coaches Limited (SCCL)** through its wholly owned subsidiary, **Braddell plc (Braddell)**. SCCL operated the **Scottish CityLink (CityLink)** business.

4. CityLink provides coach services, operating a network of routes throughout Scotland (some of which are technically registered as bus services). CityLink does not supply the vehicles/drivers itself but generally sub-contracts these operations to a variety of coach operators in Scotland. CityLink does, however, set the timetable and fares and provides customer service managers in key locations. The one exception to this business model (of which we are aware) is the Inverness to Thurso (via Brora) service which is operated by a franchisee that set the fares and timetable for that service.

TRANSACTION

5. On 12 September 2005, Stagecoach transferred certain rights to provide intercity coach services in or into Scotland under the megabus and Motorvator brands (the Transferred Brands)[1] to SCCL (the Joint Venture). In return, Stagecoach acquired a 35 per cent holding in SCCL (the Joint Venture) through its wholly owned subsidiary, Stagecoach Bus.[2] SCCL appointed Stagecoach as sub-contractor to provide the services under the Transferred Brands.

6. In addition to the services within the Joint Venture, Stagecoach Bus provides bus/coach services in Scotland outside of the Joint Venture (the Stagecoach Retained Business). The Stagecoach Retained Business operates local and inter-urban bus services that overlap with CityLink services[3] that are now part of the Joint Venture.

7. An important factor in our competitive analysis is the management control of the Joint Venture. Under the terms of the Management Agreement between the Joint Venture and Stagecoach, the day to day management is delegated to Stagecoach Bus, but the Joint Venture is otherwise managed on the direction of the Board. In particular, Stagecoach Bus has the authority to set fares and pricing structures, as well as the frequency of services.

8. The extended statutory deadline is 16 March 2006.

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[1] Namely the services: 900 (Motorvator) Edinburgh – Glasgow and return; M9 (megabus) Aberdeen – Glasgow (vis Dundee and Perth) and return; M90 (megabus) Inverness – Edinburgh (via Perth) and return; and M11 (megabus) Glasgow – London (via Manchester) and return.
[2] The remaining 65 per cent is retained by Braddell.
[3] Primarily in the Fife area and North east Scotland between and including the Aberdeen and Inverness areas.

BACKGROUND

9. On 14 December 2005, Stagecoach acquired all the shares of Traction Group Limited which has a subsidiary (Strathtay Scottish Omnibuses Limited) which provides bus services in Scotland (the Traction acquisition). The OFT is currently considering the effects of that transaction on competition as part of a separate investigation. This decision does not consider the competitive impact of the Traction acquisition.

JURISDICTION

10. This transaction gives rise to one or more merger situations in that Stagecoach has acquired the ability materially to influence the policy of CityLink, and Braddell has acquired, through CityLink, a controlling interest in the rights to operate Motorvator and certain megabus services previously controlled by Stagecoach.

11. For each merger situation, the parties overlap in the supply of intercity coach services in Scotland. While the OFT has no precise share figures, the parties are the two major suppliers of scheduled long distance coach services in Scotland. The OFT believes that the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met and, therefore, it is or may be the case that one or more relevant merger situations have been created.

RELEVANT MARKET

12. The parties overlap in the supply of bus/coach services in Scotland. In particular, the Transferred Brands and services within the Stagecoach Retained Business overlap with the CityLink services retained by the Joint Venture. There are no overlaps on the megabus Glasgow – London (M11) service so this is not considered any further.

13. The bus/coach/rail sectors have been considered in the past by both the OFT and the Competition Commission (CC). Annexe 1 sets out the main relevant conclusions arising from past CC reports, including: National Express Group Plc and Midland Main Line Limited, December 1996 *(NEG/Midland Main Line)*; National Express Group Plc and ScotRail Railways Limited, December 1997 (*NEG/Scotrail)*; FirstGroup plc and the Scottish Passenger Rail Franchise, June 2004 *(First/Scotrail)*; Arriva plc and Sovereign Bus & Coach Company, January 2005 *(Arriva/Sovereign)*; and FirstGroup PLC acquisition of the Greater Western Passenger Rail Franchise, March 2006 *(GWF)*.

Product market

14. OFT guidance makes clear that market definition is not an end in itself; it is a

framework for analysing direct competitive pressure faced by the merged firm. In the context of differentiated product or service markets, the analytical discipline of market definition helps identify the extent of immediate competitive interaction between the parties' value propositions to their customers, which in this case are consumers.[4]

15. That said, the availability of direct evidence on the central question of unilateral effects (discussed below) has rendered market definition in this case less critical to our assessment. We address the parties' arguments on market definition below and under our assessment of unilateral effects where appropriate.

16. Using the most widely used test for market definition, we considered whether it would be profitable for a hypothetical monopolist in the supply of coach services to impose a small, but significant (five to ten per cent) non-transitory price increase on users of coach travel.[5] Exceptionally for a merger investigation, we have direct evidence to assess this question, since fares on overlap routes have increased since the Joint Venture was established. Exact quantification of the increase is however difficult as the parties use a complex yield management system to set fares. Nevertheless, it is clear that the parties have reduced quotas of cheaper tickets and increased the headline fares of some tickets. For example, the headline single Motorvator fare on the Glasgow-Edinburgh route was increased from £3.50 to £4.00 after the formation of the Joint Venture, a 14 per cent price increase. The OFT believes, therefore, that there is, prima facie, strong evidence that substitution to another mode of travel does not make a five to ten per cent price increase by coach operators unprofitable.

17. We also have considerable indirect evidence of the close competitive interaction between CityLink, Motorvator and megabus including strong evidence of actual competition leading to a reduction in fares; increase in innovation; and improved service levels. In relation to fares, one of the parties' internal documents suggests that price is a primary factor in passengers' transport choice, and that there is switching between coach competitors if there is a significant difference in price. The evidence suggests that the entry of megabus onto flows operated by CityLink had led to a substantial reduction in coach fares on some flows, although exact quantification is difficult, as discussed above. Innovative activity prior to the Joint Venture included

[4] OFT, *Mergers – Substantive Assessment Guidance*, paras. 3.11 and 3.22

[5] The CC noted in its *NEG/ScotRail* report that the distinction between registered bus services (services which stop less than 15 miles apart and are registered with the Traffic Commissioner) and coach services in Scotland is blurred (paragraphs 2.66-2.75). This still appears generally to be the case given the difference between the two modes is technical and no evidence has been provided to contradict this statement. However, the degree of competitive interaction between the bus and

promotional initiatives to attract passenger numbers and competition in sales channel activity between the parties.

18. The parties' internal documents also underline the importance of competition between the parties pre Joint Venture. For example:

- CityLink (in particular) closely monitored the activity of megabus and responded to price changes

- CityLink's documents discuss the significant financial impact of Motorvator and megabus on its profitability[6] and possible strategies to counter Motorvator and megabus[7]

- the parties' customer research shows significant switching by consumers between the two parties. For example, CityLink's market research notes that [60 to 80 per cent] of CityLink passengers ([50 to 70 per cent] of the megabus passengers) switch between the CityLink and megabus brands where there is a choice.[8]

19. There is therefore substantial compelling evidence that indicates that, pre Joint Venture, CityLink and Motorvator/megabus were each others' closest competitors on overlap flows.

Other modes of transport

20. While the extent of the substitutability between alternative modes of travel can differ depending on the flow[9] being considered, some general observations on substitutability between rail, coach/bus and car are set out below.

Rail and Coach/bus

21. We have considered whether there is any evidence to suggest that rail fares would constrain a five to ten per cent increase in coach fares, despite the evidence cited above.

22. The parties presented a number of arguments to support their contention that coach and rail services are part of the same frame of reference. First, the parties believe

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coach services has been assessed as far as practicable on an individual flow basis.

[6] For example, [CityLink internal document].

[7] [CityLink internal document]

[8] CityLink document: [CityLink internal document] [ ]

[9] See paragraph [27] below for an explanation of the term 'flow'.

that the geography of Scotland (distances between cities tend to be shorter than they are in England) makes switching between intercity coaches and rail services more likely, in particular as intercity coach services serve long-distance flows and often have similar journey times to rail. Secondly, coach timetabling and fares are calculated to ensure competition with rail. Thirdly, the parties refer to the *NEG/ScotRail* report, where the CC recommended divestment by National Express Group PLC (NEG) of the CityLink business when it acquired the ScotRail Franchise. We have addressed each of these arguments in turn.

23. The evidence suggests that there are significant differences in the characteristics of coach and rail travel on many of the overlapping flows. The evidence available confirms that there is typically a price premium attached to rail fares. Third party evidence notes that walk-up rail fares are typically 20-50 per cent more expensive than coach. Rail services were generally faster than coach travel. There are therefore significant differences in the characteristics of coach and rail services, but the degree of these differences is considered in more detail on specific flows below.

24. We received mixed evidence from both the parties and third parties regarding the role of rail travel in setting coach/bus prices and timetables in contrast to the strength of evidence regarding competition between Stagecoach and CityLink pre Joint Venture. The parties provided some evidence which showed monitoring of rail fares and documents quoting the competitive impact of rail on coach. However, the parties were unable to provide any internal documents to demonstrate how rail fares are factored into the price setting methodology and/or budgeting. Although indicative of the potential for some element of competition, the evidence does not necessarily imply that rail fares act as a close constraint on coach fares, in particular given the weight of compelling evidence of the closeness of competition between Stagecoach and CityLink pre Joint Venture.

25. The *NEG/Scotrail* report considered whether competitive harm could arise, when NEG, the owners of CityLink at the time, acquired Scotrail. The question addressed by that inquiry was whether, at that time, a hypothetical monopolist of rail and coach provision could profitably impose a five to ten per cent price increase on customers. The conclusion was that it could and, therefore, NEG was required to divest CityLink. In this investigation, the question is the extent to which third party rail operators (including Scotrail) have the ability to constrain the coach services of the parties after the formation of the Joint Venture. There is substantial evidence of recent competition between the parties driving down prices significantly (and to a lesser degree, increasing innovation and increasing service levels) and of post merger price increases, notwithstanding the presence of Scotrail. The evidence, therefore, indicates that, in general, direct coach-on-coach competition is a significantly

stronger competitive constraint on fares, service levels and innovation than competition between rail and coach operators. However, the degree of substitution between coach and rail on point-to-point flows can be highly flow specific and is considered further below.

Coach and car

26. The parties and some competitors suggested that private car travel competes with public transport. However, evidence collated by the CC in recent investigations[10] suggests that generally there is limited substitutability between public and private transport in response to price changes, although the exact extent of substitutability varies depending on, amongst other things, the level of car ownership in the area and whether the journey made is urban or rural. While the parties maintained that private car travel was a key constraint on both bus and rail operations, limited evidence was provided to support this proposition. In fact, there are 11 per cent fewer cars per head (albeit increasing) in Scotland than in England, suggesting that car travel is less likely to be a constraint than elsewhere in the country.[11] For the purpose of this decision, private car travel will not be considered in the relevant frame of reference.

Geographic market

27. The OFT and the CC have previously considered local markets on the basis of the substitutability of competing services from one point to another. In making a journey, passengers travel from a particular origin to a particular destination. Such point-to-point journeys are known as 'flows'.[12] A flow may constitute an entire train or bus route, or it may be only a part of a longer route. It is therefore appropriate to focus on point-to-point flows where an overlap exists, consistent with past cases.

Summary

28. In summary, the relevant frame of reference for assessing the competitive effects of this transaction is considered to be the supply of passenger transport services on point-to-point flows.

[10] Including *Arriva/Sovereign*; *FirstGroup/Scotrail;* and *GWF.*

[11] TAS Passenger Transport Monitor for Scotland 2006, pp.21-22.

[12] See *FirstGroup/Scotrail* and the OFT's decision in the anticipated acquisition by FirstGroup plc of the Greater Western franchise of 30 September 2005.

HORIZONTAL ISSUES

Introduction

29. The theory of harm in this case is that the transaction has led to a lessening of actual/or potential competition that has resulted, or may be expected to result, in one or more of the following effects:

- fares being set higher than they otherwise would be; and/or
- levels of innovation being lower than they otherwise would be; and/or
- service levels (e.g. frequencies, punctuality, the number of services, coach/bus service quality, last/first service times, and route configuration) being lower than they otherwise would be.

30. We have examined the theory of harm in relation to each of:

- the prospect for a unilateral effect[13] on the overlapping flows brought within the Joint Venture;
- the prospect for a unilateral effect on the overlapping flows between the Stagecoach Retained Business and the Joint Venture;
- the loss of potential competition between the parties on flows on which they did not overlap pre Joint Venture; and
- the prospect for an increased risk of co-ordination[14] in the provision of coach travel.

Overlapping flows within the Joint Venture

31. We have considered, on the basis of the evidence available, the likelihood of a substantial lessening of competition on overlapping flows having resulted or being expected to result from overlapping flows within the Joint Venture.

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[13] A unilateral effect refers to independent or non-coordinated actions by market participants resulting in customers' welfare being reduced, usually by prices being raised. See paragraph 4.7-4.10 of Mergers – Substantive Assessment Guidance.

[14] A merger may lessen competition substantially by increasing the probability that, post-merger, firms in the same market may tacitly (or expressly) coordinate their behaviour to the detriment of consumers, typically by raising prices. See paragraphs 4.11-4.16 of Mergers – Substantive Assessment Guidance.

32. First, as noted above, the entry and expansion of megabus in Scotland and the acquisition of the Motorvator brand in 2004 led to a reduction in fares and increased consumer choice/service levels on the overlap routes. Post merger, there has been an increase in fares and reduction in frequency on some overlapping flows. Frequency has been reduced on a number of services, and alterations have been made to the range of services provided, such as the first service provided being later and the last service earlier. This evidence indicates strongly that the Joint Venture has the ability and incentive to alter fares and service levels. We have not received convincing evidence that price increases and changes to frequency and service levels are not the result of a substantial lessening of competition arising from the creation of the Joint Venture, but are the result, for example, of cost increases.

33. Secondly, as discussed above, the evidence strongly indicates that coach-on-coach competition is a significantly stronger competitive constraint than competition between coach and rail (or car). As the two largest scheduled coach service operators in Scotland, the transaction would appear to raise competition concerns on the evidence available. In order to assess these concerns further on a manageable number of the overlaps in more detail, we have applied a 'filter', set out in Annexe 2, to the Joint Venture overlaps between the Transferred Brands and the CityLink business. This led us to consider in detail:

- eight overlapping flows on the Glasgow (Edinburgh) – Aberdeen (via Perth and Dundee) route;
- four overlapping flows on the Edinburgh (Glasgow) – Inverness (via Perth) route; and
- the one Glasgow – Edinburgh flow on that route.

34. Before the Joint Venture, on each of the 13 flows considered in detail, CityLink and Motorvator/megabus were each others' closest competitors, in particular, CityLink and Motorvator/megabus each provided a similar service (similar route, frequency and journey time). The transaction eliminated bus/coach competition on six of the flows, and on many of the other flows, the evidence indicated that the remaining bus/coach competitors provided only a limited, if any, constraint on the combined services of the Joint Venture, as either the competitor's frequency was significantly lower than the parties' frequency and/or there were existing agreements between CityLink and the competitor (National Express) [ ]. [See endnote 2]

35. Rail services operate on each of these 13 flows. We considered whether coach and

rail travel competed closely on any of these flows. On each flow, rail provides generally a faster service; on several flows, it is very significantly quicker. However, rail fares generally exceed coach fares, often by a considerable margin. The characteristics of the products on these flows therefore further supports the proposition that rail provides a relatively loose constraint on coach travel, such that the primary constraint is that of rival bus/coach companies.

Counterfactual

36. The parties argue that competition between megabus and CityLink was 'not sustainable' and that one or other of the parties would have exited (in Scotland) due to losses. Generally the best guide to the appropriate counterfactual is the prevailing conditions of competition before the transaction.[15] Limited evidence was provided to support the parties' assertions or to support the criteria of the failing firm defence.[16] In fact, CityLink indicated that its operations had been forecast to be [ ] for both financial years 2005 and 2006 absent the merger.[17] The evidence from Stagecoach indicated that in 2004-5 megabus had been [ ]. However, [ ] such as megabus, and the evidence was limited. The available evidence therefore does not suggest that departing from the prevailing conditions of competition would be appropriate in this case.

37. In contrast to the parties' arguments, CityLink evidence suggests that competition might have become fiercer absent the Joint Venture than before. There is evidence that CityLink were considering a number of potential strategies – including 'stay and fight' and/or 'sit tight and contain' – in addition to a possible sale of the business. Even if the parties would have rationalised services on some of the overlap flows to reduce spare capacity; avoid unnecessary service duplications; and so reduce losses, this would not, necessarily, have substantially reduced pre-merger competition and consumer choice. Overall, the evidence suggests that absent the merger, the parties might have been expected to continue to compete at least as strongly on the overlap flows. [See endnote 3]

Barriers to entry and expansion

38. The parties argue that the start-up costs of de novo entry as a coach operator are not substantial and would in any event be recoverable on exit from the market. However,

[15] See paragraph 3.24 of Mergers – Substantive Assessment Guidance.
[16] See paragraph 4.37 of Mergers – Substantive Assessment Guidance.
[17] At the Issues Meeting and see also [CityLink internal document]. However, a document entitled [CityLink internal document] referred to [ ] that had recently been projected.

entry on a scale (and with the required frequency) sufficient to provide a close competitive constraint on the Retained Businesses or the Joint Venture would require significantly more investment.

39. The strongest evidence that entry (and the threat of entry) should be considered a significant competitive constraint might be expected to be the entry of megabus on the Dundee – Glasgow – Edinburgh route in September 2003 (and expansion in 2004). However, the decision of Stagecoach to withdraw its loss-making megabus Edinburgh-Glasgow service, after Stagecoach's purchase of the Motorvator brand to enter the route on a more significant scale in September 2004, underlines the importance of differentiation in this sector.[18] The entry of those brands (megabus and Motorvator) was arguably the result of a gap in the market for (budget) coach provision. Post Joint Venture, the continued operation of both the CityLink and megabus brands on a number of flows with some differentiation between them will reduce the ability of any potential new entrant to seek to differentiate its offering. The evidence suggests that prices have been increased over[19] nearly five months, and no entry has occurred on any of the overlapping flows. The Joint Venture budget documents[20] forecast revenues assuming that there will be no entry, which gives some indication of the parties' expectations.

40. Furthermore, the threat of retaliation by an incumbent provides a significant strategic barrier to entry. This is supported by previous CC reports,[21] third parties response to this investigation, the parties' own submissions to previous merger inquiries, and internal documents of CityLink. For example, CityLink documents noted that any action against Stagecoach routes would be strongly resisted by Stagecoach, e.g. enhanced frequencies, fare offerings and the possible introduction of retaliatory new competition against other CityLink routes.[22]

41. This evidence suggests that it was difficult even for an operator with an existing network to break into flows operated by another firm. Furthermore, the Joint Venture may make retaliation by the merged entity more credible and potentially damaging, as it could occur on more flows and/or using more capacity on a given flow, and therefore make entry less likely.

42. Entry against an established incumbent would seem particularly difficult on flows on

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[18] The CityLink document entitled [CityLink internal document].

[19] Megabus pricing bands and quotas changed on 10 October. We understand adjustments to quotas are however made on an ongoing basis.

[20] [CityLink internal document].

[21] For example, see *FirstGroup/Scotrail*, paragraphs 5.58-5.59.

which the parties claim there was over-capacity prior to the Joint Venture, such that there would not appear to be sufficient demand to support new entry. Branding may also represent a barrier to entry, as the acquisition of the Motorvator brand by Stagecoach may indicate.

43. The remaining competitors, with the exception of First and NEG, are all relatively small in size in comparison. The examples of recent entry by smaller competitors provided by the parties were on a limited scale and indicate that such competitors only pose a limited threat of entry. Furthermore, because they can only operate a limited number of flows, a strategy of predation or vigorous competition by the Joint Venture is more viable. While First is the largest provider of scheduled bus services in Scotland (and also operates the ScotRail franchise) it has been in this position since 1997. First has not sought to enter the coach sector since that time – although it has introduced some 'express' bus services within Glasgow these have tended to be in response to entry by Stagecoach[23] – and there is nothing to suggest that the Joint Venture would make entry by First into the coach sector any more likely than before the introduction of megabus (when prices were higher than in the period of competition between megabus and CityLink). NEG is also present in Scotland and CityLink's internal documents[24] note the possibility of NEG's expansion. However, this presence is limited, so it is unclear whether it could enter on a sufficient scale within a reasonable period to constrain the Joint Venture services and the references in the internal documents are minor. Furthermore, the OFT received evidence [ ] which may cast doubt on the constraint placed by NEG. Finally, the threat of entry and/or expansion by other operators has not constrained post Joint Venture price increases.

44. The parties provided some examples of bus entry (including smaller scale entry) and expansion by smaller operators onto smaller routes/flows. A concessionary fares scheme is expanding in April and may provide opportunities for entry and expansion. The parties submitted that previous fare concession schemes, particularly in Glasgow, resulted in [ ]. Documents provided by the parties indicate that concessionary fare schemes may provide/encourage expansion (and entry) opportunities and the new concessionary fare scheme in April may affect future entry/expansion. However, it is unrealistic to believe that such entry and expansion would be sufficient in scope to offset the loss of competition identified.

45. Overall, entry and expansion is not sufficient in timeliness, likeliness and scope to

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[22] [CityLink internal document].
[23] NEG/Midland Main Line, paragraph 2.71.
[24] [CityLink internal document].

constrain the parties' setting of competitive parameters closely.

Buyer power

46. Coach/bus users are individuals and it is therefore unrealistic that they are able to exercise any degree of countervailing buyer power. Moreover, the Joint Venture has removed some of the choice they would have had pre Joint Venture to seek the best deal from either party.

Assessment

47. The weight of evidence therefore indicates that, pre-Joint Venture, the parties were each others' closest competitors. The entry and expansion of megabus in 2003/04 led to actual coach on coach competition on the overlap routes resulting in lower fares and an increase in innovation and service levels. Post Joint Venture fares have increased and service levels and consumer choice have been reduced. Incentives to innovate may also have been reduced. Therefore, the OFT believes that the transaction has resulted in a substantial lessening of competition on the Joint Venture overlapping flows, in particular as prices have been increased, frequencies reduced, and service alterations made on some flows post Joint Venture.

Overlapping flows between the Joint Venture services and the Stagecoach Retained Business

48. We considered whether, on flows where the Stagecoach Retained Business and the Joint Venture operate bus/coach services, post Joint Venture, Stagecoach will have the ability and incentive to increase fares, reduce frequencies and/or lower innovation and service levels on those services. As set out in paragraph 7, under the Management Agreement, the Joint Venture services will effectively be operated by Stagecoach. We understand that Stagecoach currently receives [under 3 per cent] of Joint Venture revenue as a management fee, and 35 per cent of any dividend paid by the Joint Venture.

49. As with the Joint Venture overlaps, we have applied the filter described in Annexe 2 to the 85 overlapping flows between the Joint Venture and the Stagecoach retained business. This led us to consider eight overlapping flows in more detail.[25]

50. The Joint Venture services and those of the Stagecoach Retained Business are

[25] This does not include flows that were analysed as part of the joint ventures overlaps (e.g.

typically the only bus/coach competitors on each of those eight flows, and on some flows there is no rail alternative. Some of the evidence provided to the OFT suggested that passengers do in fact switch between the two services in some areas, despite differences in the services provided.

51. The evidence is mixed on whether competition concerns arise on these eight overlapping flows. Where rail is present the possible constraint provided on the bus/coach service differs depending on the flow; the frequency; and the cost differential between the services. On one flow (Inverness-Tain), the coach service is operated by a franchisee and the parties argue that situation is unlikely to change. The Joint Venture is therefore, in itself, unlikely to give rise to any competition issues on that flow. Overall, the evidence available is mixed as to whether Stagecoach would have the incentive and/or ability to implement the theory of harm on overlaps between the Joint Venture services and the Stagecoach Retained Business services. However, given that the reference test is met in respect of the Joint Venture overlaps described above, and that the Joint Venture is part of any possible relevant merger situation arising from the transaction, the OFT does not need to reach a conclusion on this issue.

Potential competition

52. On flows within Scotland where the parties did not face actual competition from one another, the service and fare levels set by the parties on these flows may nevertheless have been constrained, to some extent, by the threat of entry on that flow by the other party to the Joint Venture. The parties to the Joint Venture are the two largest scheduled coach service companies in Scotland. Internal documents indicate that prior to the Joint Venture the threat of expansion posed by each party to the other was real. In particular, parties' internal documents suggest that megabus expansion could be expected in Scotland in the absence of the Joint Venture. There is also evidence of CityLink proposing expansion to counter the emergence of Stagecoach services on some routes, including specific flows having been considered and costings calculated.[26] Nonetheless, CityLink documents noted that any action against Stagecoach routes would be strongly resisted by Stagecoach.[27] A loss of potential competition may, therefore, be likely as a result of the Joint Venture. However, no conclusion need be reached on the degree of this loss, as the reference test is met in respect of the Joint Venture overlaps described above.

Edinburgh – Dundee).

[26] Source: [CityLink internal document].

[27] [CityLink internal document].

Susceptibility of the market to coordination

53. During its investigation, the OFT has received evidence [ ] the relevant question is whether the joint venture may be expected to give rise to concerns relating to coordinated effects or exacerbate existing concerns. The Joint Venture increases concentration in an already concentrated sector. Coach services are fairly homogenous products with price being the main parameter of competition and frequency also being important. Timetables are published aiding transparency. There is however some differentiation in service levels. Furthermore yield pricing, used by the parties, may make alignment of behaviour on price more difficult, but access to these fares is freely available via their web sites. As discussed below, entry and expansion would not appear to be sufficient to destabilise co-ordination were this to arise. However, no conclusion need be reached on the prospects for co-ordinated effects, as the reference test is met in respect of the Joint Venture overlaps described above.

CUSTOMER BENEFITS

54. The parties have argued that the joint venture enables a co-ordinated timetable enabling coach services better to compete with rail. We received evidence to show that a train operator in Scotland monitors coach fares and frequency, although it was not clear how the documents were used and how exactly, if at all, rail fares were influenced by this information. The evidence available strongly indicates that competition between coach operators rather than with train operators was driving commercial decisions, such as price setting, on the overlap routes pre Joint Venture. Furthermore, no evidence has been put to us to show any competitive response by any overlapping train operator after the post Joint Venture price increases. Finally, the Joint Venture has resulted in higher prices to consumers, which is not consistent with the aim of increasing competition with train operators.

VERTICAL ISSUES

55. This transaction does not raise any vertical competition concerns.

THIRD PARTY VIEWS

56. Third party views were mixed. There were a number of unsolicited complaints by consumers about price increases, reductions in service levels and frequencies, and a loss of choice and competition. Competitors and contractors identified by the parties were not concerned, but many indicated that they did not compete with the parties,

and/or that the parties were each others' closest competitor.

ASSESSMENT

57. The transaction combines most of Scotland's intercity coach operations and the parties to the Joint Venture were each others' closest competitors.

58. The transaction appears to have led to a substantial loss of actual competition between the parties on all flows where the services of megabus/Motorvator and CityLink overlap. The parties maintain that the constraints imposed by other forms of transport, particularly rail services, and the threat of new entry and expansion, would be sufficient to allay any concerns. Nonetheless, the substantial evidence obtained in this investigation strongly indicates that rail services and the prospect of entry have not constrained substantial price increases and reductions in frequencies in the past, and will not do so in future. In particular, entry and expansion does not appear to be sufficient in timeliness, likeliness and scope to defeat or to constrain the parties' setting of competitive parameters closely. Furthermore, it is implausible that the transaction will increase rivalry with train operators sufficiently to offset the harm to coach customers identified.

59. The transaction also gives rise to overlaps between the Stagecoach Retained Business and the Joint Venture which might lead to a reduction in competition on certain flows. However, given the conclusions on the overlaps within the Joint Venture it has not been necessary to conclude on the significance of the loss of competition from this aspect of the transaction.

60. Consequently, the OFT believes that it is or may be the case that the merger or mergers resulting from the transaction have resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom. The parties made no offer of undertakings in lieu of reference.

DECISION

61. The mergers will therefore **be referred** to the Competition Commission under section 22(1) of the Act.

ENDNOTES

1. Stagecoach wishes to clarify that it sold its New Zealand business in the autumn of 2005.

2. The parties wish to clarify that in November 1995 steps were taken to end the agreements referred to.

3. The parties wish to clarify that the proposals did not find favour with the CityLink pre-jv board.

Annexe 1 – Previous CC reports

1. Previous Competition Commission (CC) reports have considered the substitutability of coach, bus, rail and private transport.[28] They note that passengers' choice between modes of travel (including rail, coach, bus and private travel) will be a function, amongst other factors, of length of the journey, access to a particular means of transport (both boarding and disembarkation points), personal preference, the cost of the journey, the journey time (including time spent getting to and from stations and bus/coach stops), frequency of services and whether direct services are available. These factors are sometimes included in a wider measure of 'generalised cost' of a journey which passengers try to minimise when travelling (see *Arriva/Sovereign* Annexe D for more details).

2. The CC, in previous reports, has considered the effect of direct coach on coach competition. In the context of *NEG/Midland Main Line*, the CC found that competition between coach operators had a strong impact on coach fares.[29] The CC also found that it was actual competition rather the threat of potential competition that has been the main reason leading to fare reductions (the fare reductions had taken place only on the route in which there was direct coach on coach competition).[30] The CC concluded that while the merger reduced competition between coach and rail on the specified services had there been 'rigorous competition from other coach operators... we would not have been concerned'.[31]

3. The CC has noted in previous reports[32] that the substitutability between bus, coach and rail services depends on the characteristics of the geographic area, routes and flows concerned. For example, in the *NEG/Midland Main Line* report the CC took the view that the price of rail travel would impact on coach passenger numbers, and vice versa.[33] Moreover, in *FirstGroup/Scotrail* the CC concluded that train and local buses were at least potentially substitutable on some routes.[34] In contrast, in *GWF*[35] the CC stated that on the majority of flows considered bus and rail services to a large extent had different characteristics and met different passenger requirements.

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[28] See the reports listed in paragraph 13 of the main body of the decision.
[29] Paragraph 2.50.
[30] Paragraph 2.54.
[31] Paragraph 2.67.
[32] For example, *Arriva/Sovereign*; *FirstGroup/Scotrail*; and *NEG/Scotrail.*
[33] For example, see *FirstGroup/Scotrail* annexe E.
[34] Paragraph 4.28.
[35] Paragraph 11 of the Summary. Unlike *FirstGroup/Scotrail* case, other rail operators have a greater presence on many of the flows.

Annexe 2 – Filter

1. As set out above, the parties are both active in the supply of bus/coach services in Scotland. As such, there were a large number of overlapping flows, both within the Joint Venture itself and between the Joint Venture and the Stagecoach Retained Businesses.

2. In conducting our investigation, the OFT has considered the filters used in previous transport cases. For example, in *FirstGroup/ScotRail* the CC identified routes where the percentage of revenues on a bus route accounted for by all overlap flows taken together on that route exceed 10 per cent. In that case, the CC believed that it would be difficult or counterproductive to change the operation of the route where overlapping flows made up less of the overall route.[36]

3. However, such filters are pragmatic, need to be checked for robustness/sensitivity, and could be case-specific (see *FirstGroup/ICEC* Commentary).[37] The validity of these filters should be tested in any given case, rather than simply applied mechanically. Given the large amount of overlapping flows in this case, for the purposes of our competitive assessment we have only considered flows where the revenue for the flow (from either party) exceeds 10 per cent of the revenue for the route from the relevant party.

4. While rather more limiting that that used in *FirstGroup/Scotrail,* this filter has been applied in this case as a starting point and to bring the analysis of the competition issues down to a manageable level. This does not mean, however, that the flows sifted out by the filter have been dismissed by the OFT as unproblematic.

[36] Paragraph 5.14.
[37] See CC, *FirstGroup/ICEC* (terminated) merger inquiry: commentary on issues statement, 20 June 2005 (*FirstGroup/ICEC*).