OFFICE OF FAIR TRADING

# Anticipated acquisition by First West Yorkshire Limited of Black Prince Buses Limited

The OFT's decision on reference under section 33 given on 27 May 2005. Full text of decision published 8 June 2005.

## PARTIES

1. **First West Yorkshire Limited (First)** is part of First Group plc which operates transport services across the UK, including bus operations in and around Leeds using a fleet of over 450 vehicles and three local depots.

2. **Black Prince Buses Limited (Black Prince)** has around 40 vehicles which it operates from its depot in Morley, about eight miles from the centre of Leeds. Its turnover in the year to 31 March 2004 was £2.8m.

## TRANSACTION

3. First proposes to acquire for £[][1] the operating licences, tendered contracts, staff contracts and goodwill of Black Prince but not the associated vehicles. Black Prince's depot is being sold to a third party.

4. The administrative deadline is 18 June.

## JURISDICTION

5. As a result of this transaction First and Black Prince will cease to be distinct. The parties overlap in the supply of bus services in Leeds and 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.

## RELEVANT MARKET

### Product market

6. In line with recent OFT decisions and Competition Commission (CC) reports, the OFT's starting point is to consider bus services separately from other modes of public transport, except where journey characteristics on the other mode of transport (e.g. rail, coach) are sufficiently similar on a specific point to point

[1] Business secret excised at the request of the parties.

overlap as to suggest substitutability between the respective modes.[2] The parties have not contested this general approach but have not provided the evidence necessary to determine whether, in this case, rail journey characteristics for local services in Leeds are sufficiently similar on specific point to point overlaps at issue.

7. The parties run both commercial and tendered bus services, and operators of either type of service can easily provide the other. However, the ability to alter both price and service levels on tendered services is controlled by the tendering authority rather than the operator. From a demand-side perspective, commercial bus passengers cannot switch to tendered services as the two types of services tend to run at mutually exclusive times of the day and week. In view of these characteristics, the two services will therefore be considered separately.

**Geographic market**

8. As bus passengers seek to travel from a fixed point of origin (A) to a fixed destination (B), demand-side factors warrant separate consideration of the transaction in terms of its impact on a point-to-point basis, i.e. supply of passenger transport services from A to B.

9. On the other hand, past cases suggest that supply-side substitution between point to point routes may be relatively easy for incumbent operators with scale. First submits it sets prices across the whole of the Leeds operating area, rather than a route-by-route basis. The prospect of supply-side substitution, the argument that First's competitive variables are set at a 'network' level, and the CC's previous approach to this issue[3] indicate that the transaction's competitive effects in relation to the Leeds area as a whole should also be considered.

10. It is therefore appropriate in this case to take as the frame of reference both (i) commercial and (ii) tendered bus services on point to points, individually and in aggregate, corresponding to Black Prince's actual and potential scope of operations in and around Leeds.

**HORIZONTAL ISSUES**

**Tendered services**

11. Black Prince has bid for very few tender contracts (8 out of 167 between 2002 and 2004) in recent years but appears to have been First's main competitor on bids for local urban out of hours contracts, where the average number of bidders is 1.1. Given the very limited level of bidding competition, the removal of Black Prince as an occasional bidder may be regarded as proportionately more significant, and this view is reinforced by third party concerns to this effect.

---

[2] The most recent of which is the CC report on the acquisition by Arriva plc of Sovereign Bus and Coach Company Ltd, January 2005 (Arriva/Sovereign).
[3] This approach is discussed in particular in Monopolies and Mergers Commission, Arriva plc and Lutonian Buses Ltd: A report on the merger situation, 18 November 1998, paras. 2.22-2.23.

**Commercial services**

12. Black Prince operates 10 commercial services, the routes of 8 of which overlap directly with 28 First services.[4] Post merger, First would account for 83 per cent of bus passenger miles in Leeds (increment 9 per cent). Arriva accounts for 12 per cent of bus passenger miles. The remaining 5 per cent is accounted for by three smaller rivals.

13. The level of overlap and the absence of a competing bus service on all but one overlapping route, would suggest Black Prince is First's closest competitor, at least on the individual routes in question. Closer examination of comparative frequency, proportion of revenue accounted for by the overlap and presence of other competitors on all of the individual overlapping flows (segments of a route between two points where the parties directly overlap) confirms this. Even if such an assessment of these three factors is conducted by reference to the thresholds of concern used by the CC in First/Scotrail, as argued by the parties in their last submission, 11 of the 28 First routes do not 'pass'.[5] While this methodology provides a useful indication in a case involving a large number of overlaps of where the largest loss in direct, actual competition on flows is likely to occur, it would be inappropriate to accord it excessive weight: such a methodology developed in the factual context of a particular CC merger investigation does not, in the context of a separate OFT inquiry, create a 'safe harbour' of flows removed from the OFT's scrutiny or in respect of which presumptively no concerns could arise.

14. It appears unlikely that the prospect of new entry would alleviate competition concerns, including on the 11 services highlighted by the above methodology. Although financial costs of entry might be modest and property suitable for depot facilities may be available in the area, there is no evidence of substantial entry by new operators in recent years, or of expansion by existing operators on to new routes. Nor is there any evidence that such entry or expansion may be forthcoming in the future. Arriva has withdrawn its inner Leeds services (concentrating on long distance from surrounding towns and cities that pass through the parties' operating areas on their way in to the centre, such that it only overlaps with both on one flow) and smaller rivals cite as deterrents to entry the strong position of First and the risk relative to the low level of return from the routes, which are some distance from their depots (none of which are in Leeds).

15. First asserts that competition between the parties has been very limited in recent years, pointing to changes in fares and frequencies on the overlapping services in recent years, which suggest that Black Prince has simply followed changes initiated by First. However, it is clear from internal documentation that at least up until 2002 (when the sale of the business was first mooted) Black Prince was

---

[4] First considers that passengers in Leeds will walk 400m on average to a bus stop. As such, if bus routes running within a few hundred metres of each other are indeed substitutes for passengers on this basis, then the proportion of the route over which the 28 services overlap increases, as may the number of services which overlap.

[5] See the CC's report in First Group plc and the Scottish Passenger Rail franchise: A report on the proposed acquisition by First Group plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited, June 2004 (First/Scotrail) and Arriva/Sovereign (where the method was applied to a merger of two bus firms).

considered by First to be an effective competitor, and product innovation by both parties in ticket types in 1999/2000 was a response to competitive pressure they placed on each other on particular routes. However, even if the parties' view of the current level of competition were accepted, the fact that they are each other's closest substitutes (i.e. the only two operators of public transport) on many routes, and that current competition from other operators is either absent or limited, means that the loss of competition from Black Prince may be regarded as substantial. For example the presence of Black Prince may constrain greater price rises or service reductions than have occurred to date. Indeed, First's [][6]. As neither First nor Black Prince have unilaterally reduced capacity on the overlap flows pre-merger, this strongly suggests that it is competition between them is keeping bus frequencies (and thus service levels to passengers) at their current levels.

**Conclusion**

16. The above analysis indicates a potential for serious competition concerns and suggests that, post-merger, passengers in Leeds may suffer a reduced number of bus services and frequencies and higher prices compared to those that have prevailed to the present.

**COUNTERFACTUAL**

17. In order to decide whether or not it may be the case that the merger may be expected to result in a substantial lessening of competition, the OFT considers the merger's impact relative to the situation expected to prevail absent the merger (i.e. the counterfactual). Generally speaking, this will be prevailing conditions of competition, but in this case, Black Prince has submitted that it will exit regardless of the transaction under consideration. In order to treat this submission as the appropriate counterfactual for assessment of the merger situation, the OFT requires sufficient compelling evidence, particularly as the postulated counterfactual involves the exit of one of the merging parties, even in the absence of the merger.[7] In effect, in such circumstances parties are arguing that, to the extent competitive harm may arise, the merger is not the cause of that harm as it would in any event occur. Where absence of causation between the merger and the lessening of competition is alleged, the OFT will as a matter of policy seek a high level of supporting evidence (although the standard of belief relevant to the assessment of that evidence remains the same as that set out in the reference test of the Act).

**Black Prince's inevitable exit?**

18. Although not on the verge of administration or liquidation, Black Prince has submitted that a number of factors support its assertion that its exit from Leeds is irrevocable and unconnected to First's offer:

- Black Prince, a family-owned business, is managed by its founder Brian Crowther, who has been seeking to sell the business and retire on medical grounds since before First made an offer. Irrespective of his personal

[6] Business secret redacted at request of the parties
[7] See BAI/P&O Ferries, decision of 7 December 2004 (BAI/P&O); Taminco/Air Products, decision of 16 July 2004; Arcelor/Corus, decision of 9 September 2004.

circumstances, Mr Crowther's intent regarding Black Prince's exit as an independent business is strongly suggested by the fact that he approached informally a number of potential bidders, including First, Arriva and Blazefield, and from February 2003 undertook a substantial public campaign to find other bidders.

- The finances of the business appear unsustainable unless restructuring is undertaken. The accounts indicate Black Prince has a negative cash flow and will be loss making in year ending 30 April 2005, at least in part driven by steep increases in insurance costs (40 per cent in 2004 and 30 per cent in 2003). Black Prince submits that it has made no operating profit in recent years; its balance sheets show a small profit in the previous two financial years only due to sales of its vehicles being allocated to cash flow, a revenue-raising option which is no longer available. The business is currently supported by an overdraft with a rolling extension, which will be reviewed and may cease if this sale falls through. Costs are expected to continue to rise, particularly with only one insurance provider being prepared to quote for Black Prince's business, debt restructuring and investment in replacement assets.

- There may be some scope for re-structuring the business in the hands of a third party, assuming there was one. (Black Prince suggests that it has hitherto preserved loss-making routes whilst the prolonged sales process was ongoing so as not to be offering for sale a shrinking business). However, there is no material prospect of such a restructuring being directed from within the company. There appears to be no credible candidates within the business for succession or management buy-out and there is little incentive for Mr Crowther to invest capital that would otherwise support his imminent retirement to maintain in the medium term a deteriorating business with limited profitability whose ability to raise extra revenue via fare increases is limited by strong competition from First. For example, significant investment would be required in a new depot if the business was to continue to operate beyond October 2005, as the sale of the depot is the subject of an unconditional agreement to sell it to a property developer signed in March 2005. This in itself strongly suggests Black Prince intends to exit irrespective of the outcome of this merger. Mr Crowther wished to sell the depot separately from the rest of the business and undertook a sales process independent of the proposed transaction, which does not cover the depot.

19. In the light of the above, the OFT is satisfied that Black Prince has no serious prospect of re-organising its business and that it will exit the provision of bus services in Leeds even in the absence of the transaction with First.

**Less anti-competitive alternatives to the merger**

20. In the present case however, given First's existing position in Leeds, it appears that any other realistic buyer would result in lower post-merger concentration levels and potentially represent a less anti-competitive alternative to the merger. In order to be satisfied that no realistic or credible alternative purchaser exists, the OFT has sought to gather sufficient compelling evidence on this point. On the basis of the evidence it has seen, the OFT is satisfied that there is no such alternative. In this connection, the following points are relevant:

- Prior to signing an agreement with First in November 2004, Black Prince undertook a considerable marketing campaign to dispose of its business. The effort and resource dedicated to this was very substantial in relation to the size of the business being sold. Having made informal approaches in 2002, information memoranda on the business were distributed to 60 local commercial bus operators, the top bus operators throughout the UKand other bus companies that had made an acquisition in the previous three years. The sale of the business was also promoted through a nationwide network of advisers and accountants. The OFT is therefore satisfied that Black Prince has made substantial good faith efforts to elicit offers other than from First, but very little interest in seeking further information was expressed, and First was the only firm actually to submit a bid.

- The lack of interest in acquiring Black Prince is confirmed by third parties, who generally regarded the business as in poor condition, too far from their respective centres of operation and of limited profitability given the strong presence of First, in the face of which some had already exited Leeds. First, on the other hand, appears to be the only bidder for whom the acquisition is attractive, given that it can benefit from economies of scale and has local depots.

- No venture capital interests responded to contacts made regarding a management buy-in offer. Given the high level of gearing and the limited return in the bus industry for smaller operators, Black Prince would not be a natural target for such investment.

21. If Black Prince exits the market, the merger does not proceed, and no-one enters, the result will be a reduction in service which would not, in itself, be in the interest of customers. While it is conceivable that Black Prince's exit may promote competition between First and Arriva on the existing overlap and/or make entry more viable to capture freed-up demand, the pattern of competition to date in this market suggests that the chances of this occurring are remote. Third party views on the likelihood of entry/expansion universally support this view.

22. Overall, there is sufficiently compelling evidence that there is no realistic outcome less anti-competitive than acquisition by First, even though this creates a single supplier on, at least, the overlapping routes, and enhances First's position in Leeds as a whole.

**VERTICAL ISSUES**

23. There is no evidence to suggest that significant vertical issues arise in this case.

**CUSTOMER BENEFITS**

24. First claims that customers will benefit from an uninterrupted service, investment in new vehicles and technology and greater integration of services than if the merger did not proceed. Given the above assessment of the merger this exception to the duty to refer is not considered further.

## THIRD PARTY VIEWS

25. Other bus operators and customers of both commercial and tender services expressed concern about the merger. Most regarded the parties as competitors. No third party saw any likelihood of entry in the area in question, nor expressed any serious interest in acquiring Black Prince.

## ASSESSMENT

26. First intends to acquire Black Prince, a family-owned independent bus operator and the only bus competitor to First on a substantial number of routes in Leeds. The transaction raises substantial initial competition concerns due to the high (83 per cent) combined share of supply in Leeds, the degree of route overlap on which the parties are the only two bus operators, third party concerns, and little prospect for entry as a constraint.

27. The key question posed by this case is causation: would the anti-competitive post-merger outcome suggested by the above factors have arisen in any event, even absent the merger?

28. After careful analysis, the OFT has concluded that the typical benchmark against which merger effects are assessed – prevailing conditions of competition – is inappropriate in this case, because Black Prince has provided sufficient compelling evidence that it will cease independent operation regardless of the proposed merger. Given First's position in Leeds, the question therefore is whether there may be a less anti-competitive alternative to the proposed merger. A high evidentiary standard has been applied to this question, but Black Prince has, exceptionally, been able to meet this standard due to the cogency and overall consistency of evidence it has provided. Therefore, the OFT is satisfied that there is no realistic prospect of an alternative buyer nor of any other outcome better for competition and passengers in Leeds than a sale to First. As such, the counterfactual against which the merger must be judged in this case is a scenario in which the competitive threat from Black Prince will be lost in any event. Accordingly, the merger itself cannot be regarded as the cause of any anti-competitive outcome.

29. 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

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