
Anticipated acquisition by Stena of certain assets operated by P&O on the Irish Sea

The OFT's decision on reference under section 33 given on 22 August 2003

PARTIES

Stena AB (Stena), Stena Metall AB and Stena Sessan AB, are part of the Stena group, controlled by the Sten A. Olsson family. Stena Line provides ferry services for freight and passengers in Scandinavia, the UK, Ireland, the Netherlands, Germany and Poland. For the year ended 31 December 2002, the Stena group reported a turnover of 3.16 billion Euro, of which []¹ Euro was achieved in the UK and the Republic of Ireland. The holding company of **the P&O Group** (P&O) is a UK listed company and the group comprises ports, ferries, logistics and cargo shipping businesses. For the year ended 31 December 2002, P&O reported a turnover of £4,519 million, of which [] was generated in the UK. The UK turnover of the routes being acquired by Stena in this period was [].

TRANSACTION

The anticipated transaction involves the acquisition by Stena of five vessels, and related staff, port leases and agreements currently used by P&O on two routes on the Irish Sea between Fleetwood and Larne and between Liverpool and Dublin.

The Memorandum of Understanding detailing the above acquisition also describes a separate relevant merger situation, involving a joint venture to develop the port of Cairnryan in Scotland, which is assessed by this Office in a separate decision.

At the same time as announcing these two mergers P&O announced - as part of a decision to rationalise its activities on the Irish Sea - that it intended to cease to operate its ferry service from the port of Mostyn to Dublin and that Stena would be time chartering the two ships currently operating from Mostyn for use outside the Irish Sea. This arrangement does not constitute a relevant merger situation in its own right.

¹ All UK turnover, market share and HHI increments that have been deleted or replaced with ranges have been so altered at the request of the parties on the grounds of commercial confidentiality.

However, P&O has also accepted a restriction [that]² is not ancillary to this merger situation, as it is clearly not necessary to the transaction.

The administrative deadline for a decision is 22 August.

JURISDICTION

As a result of this transaction, P&O's ferry enterprises between Fleetwood and Larne and between Liverpool and Dublin will cease to be distinct from Stena. The parties overlap in the supply of ferry services for freight from Great Britain to Northern Ireland and the Republic of Ireland and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met in this regard. A relevant merger situation has therefore been created.

RELEVANT MARKET

Product market

Ferries operating in the Irish Sea carry freight, cars, foot passengers or a combination, depending on the type of vessel. On the demand side there is a clear distinction between freight and passenger services. Passenger services may be further subdivided as between foot and car passengers, but it is unnecessary to conclude on whether the latter are separate relevant frames of reference for the purposes of this assessment.

The freight services affected by this merger are unitised freight, such as lorry trailers, which are carried on Roll on Roll Off (Ro-Ro or Ropax, if passengers are also carried) ferries or Load on Load Off (Lo-Lo) ferries, which use cranes to load the freight containers. The parties tell the OFT that no bulk freight, such as grain, is ferried between Great Britain and Northern Ireland or the Republic of Ireland. Consequently only unitised freight is considered.

² Commercially confidential information deleted at the request of the parties.

Geographic market

Routes from Great Britain across the Irish Sea can be divided in a number of ways. The parties have done so by the port of destination, segmenting the routes into three broad corridors:

southern- routes into Cork and Rosslare in the south of the Republic of Ireland from south west Wales;

central - routes into Dublin and Dun Laoghaire from north Wales (Holyhead and Mostyn) and north western England (Liverpool and Heysham); and

northern – routes into Belfast, Warrenpoint and Larne in Northern Ireland from Scotland (Cairnryan, Stranraer and Troon) and from north western England (Liverpool, Heysham and Fleetwood). These last three diagonal crossings are characterised as being in the northern corridor because of port of destination but are also known as hybrid routes as they originate from ports in north western England also used in central corridor routes. Although, in distance, the hybrid routes are longer than the central routes, the sea crossing time is the same as for slower ferries on some central routes. The time required to drive freight from Belfast to Dublin is also less than that to drive freight from the ports in north Wales and north western England to the Scottish ports.

The P&O routes being acquired by Stena operate between Fleetwood and Larne (a hybrid route) and between Liverpool and Dublin (a central route) and both carry passengers and freight. In this assessment, we first seek to consider whether routes on different corridors act as a competitive constraint – for either passengers or freight or both – on routes in other corridors.

The southern corridor is unaffected by the merger and its relative isolation means that it is generally not considered, by third parties, to be a constraint on the central corridor. It is not proposed to consider the southern corridor any further. The transaction does have a significant impact on the central corridor and may impact on the northern corridor. For the purposes of this assessment the extent to which routes in the northern corridor – or just the hybrid routes - constitute a constraint on routes in the central corridor needs to be considered.

For ferry services for passengers, origin and destination data provided by the parties tend to indicate that destination determines the route and that therefore the two corridors present little constraint upon each other. This is supported by the lack of correlation on average prices charged to customers over time between the northern and central corridors, although it is difficult to ensure other factors are not affecting these

statistics. Ferry services for passengers will therefore be examined on the basis of two separate corridors.

Turning to ferry services for freight, price correlation data, with the same caveats, would suggest that the two corridors may be acting as some price constraint upon each other. However, the freight customers' assertion as to their own behaviour would seem to contradict that view: customers generally consider the ports in Scotland as not being substitutes for those in north western England for sending freight to the Republic of Ireland. Most customers suggested that they would switch to a competitor operating from the same port in north Wales or north western England, or at most the nearest alternative port, in response to a 5 to 10 per cent price rise. This could be a result of the extra on-road costs involved in switching to another corridor and, in one case, the fact that the customer's infrastructure was built around a specific port. Although another third party shared this view of infrastructure switching costs, the parties contend that many freight operations are sufficiently flexible to offset the longer drive to Scotland and down from Belfast by the shorter and cheaper crossing in the northern corridor. However, no examples of such switching have been provided. It is more conceivable that the customers could switch from a central corridor route to a hybrid route from north western England to Northern Ireland, as these services often operate from the same port. Although, again, there are no examples of such switching, some third parties did see new motorway infrastructure as having made Dublin and Belfast ports direct competitors³, which may make the hybrid routes a closer alternative to the more direct central corridor routes than those operating from the Scottish ports.

For freight, it appears that the greatest competitive constraint on ferry services is provided by services operating from the same port and on the same corridor since customer switching costs are lowest. Nevertheless it appears the competitive constraint is likely to be wider than this – to include other ports in the same corridor – although the extent to which this extends further to include the hybrid routes is difficult to determine. With this in mind and in the absence of clear evidence that the whole of the northern corridor forms a strong constraint upon the central corridor, the frames of reference for consideration of this merger are in respect of ferry services for freight on the central corridor of the Irish Sea (with consideration of the impact of the hybrid routes) and the northern corridor of the Irish Sea (including the hybrid routes).

³ Access to Stranraer and Cairnryan, by contrast, involves the use of single carriageway and it is a greater distance by road from the central corridor ports to the Scottish ports than from Belfast to Dublin. It should also be noted that unlike on cross-Channel ferry routes, where the crossing is on average a small part of the overall distance travelled to reach a destination on the Continent, the size of Ireland means that the Irish Sea crossing is more significant in terms of overall distance and cost.

HORIZONTAL ISSUES

Market shares

Passengers

For ferry services for passengers in the central corridor the merger produces an Herfindahl-Hirschmann Index (HHI) of some 4200, with a substantial increment of [more than 50]. Stena and Irish Ferries have [85- 95 per cent] of these passengers between them, so although the HHI increment is significant, given the duopolistic nature of the services on this corridor, the withdrawal of P&O (representing [>5 per cent] of passengers) does not appear to bring about a large change in market structure. In addition, whilst Stena and Irish Ferries both offer some 70 sailings per week with crossing times of under 4 hours, P&O's offer of 12 sailings per week and crossing times of over 7 hours may not make it a close competitor. The impact on competition would not therefore appear likely to be substantial.

The northern corridor is marginally less concentrated, although still with an HHI in excess of 3000 and an increment above 50. Post merger P&O will continue to provide a service from Cairnryan to Larne which is a close competitor to Stena's current service from Stranraer to Belfast (which Stena intends to transfer to Cairnryan from 2005). The Fleetwood to Larne service to be acquired by Stena represents [>5 per cent] of passengers on this corridor and, as a slower hybrid route, appears to be much less of a competitive constraint on Stena's existing ferry services for passengers than P&O's Cairnryan service or Seacontainers' service from Troon to Belfast.

Overall whilst the transaction is significant in terms of increment to HHI, the P&O services to be acquired by Stena would appear unlikely currently to represent a significant competitive constraint on Stena and consequently the merger may not be expected to result in a substantial lessening of competition in relation to ferry services for passengers.

Freight

For the supply of ferry services for freight in the northern corridor – and assuming the hybrid Fleetwood to Larne and the other hybrid routes to be part of the northern corridor - the merger leads to a reduction in HHI concentration of about [350-450], down to 2,640. The three major players (the parties and Norse Merchant Ferries) will each have shares of supply of approximately [25-35 per cent], with two smaller players also remaining.

In the central corridor the merger and the closure of P&O's Mostyn service will remove the leading operator, taking the number of competitors from 5 to 4, and leave Stena with approximately [35-45 per cent] of the share of supply. This will result in a highly concentrated sector with an HHI of some 3000 and a substantial increment of over [650-750]⁴. Furthermore of the three remaining competitors, two appear to have limited spare capacity and thus - given that the closure of Mostyn will take capacity out of this corridor - may only be able to impose a weak constraint on Stena. Coastal, with [5-15 per cent] share of supply post merger, operates LoLo only vessels and appears to be operating at full capacity. Norse Merchant Ferries has had a history of aggressive competition and would have around [25-35 per cent] share of supply post merger. However, it has limited spare capacity and is currently in administration, although it is expected to come out of this successfully. The third competitor is Irish Ferries, with an expected share of supply of around [15-25 per cent], which operates from Stena's port at Holyhead and appears to have significant spare capacity.

It is unclear to what extent the hybrid routes constrain freight ferry services in the central corridor. Stena is acquiring one of the hybrid routes (Fleetwood to Larne) in this transaction. However, the possible competitive constraint exercised by the 3 competitors on the other hybrid routes may also be limited. Coastal operates a LoLo only service and, according to information provided by the parties, appears to be operating at full capacity, as is Seatruck on Heysham to Warrenpoint. The remaining competitor is again Norse Merchant Ferries operating from Heysham to Belfast and Liverpool to Belfast but with limited spare capacity on both services.

The merger – together with the closure of P&O's Mostyn service - would take capacity out of the central corridor which might be expected to reduce overall Stena's spare capacity. Given its significant share of supply in this corridor Stena may be put in a position to reduce capacity further in the central corridor or raise price by other means. Norse Merchant Ferries and Coastal appear to be running with very little, if any, spare capacity in the central corridor. Irish Ferries have significant spare capacity but operate a service from Stena's port at Holyhead where Stena also has significant spare capacity. Given the substantial increase in concentration and the effective withdrawal of the main competitor on this corridor, Irish Ferries alone may not exert sufficient constraint to avert a substantial lessening of competition.

Barriers to entry and expansion

A new entrant requires a vessel and a berth at both origin and destination ports. The former appears to be easy to lease but there is currently only one spare berth at Belfast

⁴ This increment is calculated after the parties treated the Mostyn traffic as divided pro-rata between all competitors on the central corridor – technically, while not part of the merger the future of the Mostyn service is relevant to the consideration of the relevant counterfactual.

and there will only be one at Dublin once P&O has ceased its Mostyn service, limiting the scope of any new service. In addition third parties have pointed to the importance of securing enough business to justify the risk of investment. Investment in new berths or ports can occur but it does entail substantial risks, as is demonstrated by the port of Mostyn.

In terms of expanding existing freight ferry operations, it appears possible to upgrade vessels and ferry operators have done so over time, although one third party felt that expansion would only be justified if rates increased 8 to 10 per cent. Post merger in the central corridor only one operator other than Stena will have significant spare capacity.

Overall *de novo* entry is possible but limited in scope and expansion of existing facilities is possible but may only be provided in response to a significant increase in price.

Buyer power

The parties consider that large freight companies have considerable buyer power, given that they negotiate rates in advance across the range of Irish Sea services provided by a freight ferry operator. However, the ability to secure advantageous rates requires choice and spare capacity amongst competing freight operators. This concern was reflected in customer comments. In addition as the majority of rates are individually negotiated smaller freight companies, operating on only one or a few routes, would be more exposed to the effects of any lessening of competition.

THIRD PARTY VIEWS

All freight companies contacted by the OFT had concerns that the merger would strengthen the position of Stena in the central corridor, bar one which welcomed the stability and investment it saw Stena bringing to that corridor. All but one of the port operators were unconcerned and competing ferry operators were mostly unconcerned, seeing the merger as reducing capacity and stabilising the market. Other government departments raised no concerns.

ASSESSMENT

The parties operate ferry services for passengers and freight in the northern and central corridors of the Irish Sea. In relation to ferry services for passengers in both corridors, the merger will result in a small [>5 per cent] increment to Stena's share of supply. While the merger increases HHI concentration in an already concentrated market, it seems unlikely that the P&O services could have been an effective constraint upon the other major players. It seems unlikely, therefore, that, in relation to passenger services, the merger may be expected to give rise to a substantial lessening of competition.

In relation to ferry services for freight in the northern corridor alone – and assuming hybrid services to constrain services in that corridor – the merger appears to be neutral. HHI concentration would actually fall and there would remain three major players providing freight services in this corridor. On this analysis, it seems unlikely that the merger may be expected to lead to a substantial lessening of competition within this corridor.

In relation to ferry services for freight in the central corridor the merger – together with the cessation of P&O's Mostyn service - results in the elimination of the leading provider and a substantial increase in concentration in a highly concentrated market. All but one of the competitors in this corridor may be handicapped as an effective constraint on Stena by a number of factors, including operating at nearly full capacity; providing LoLo only service; and, being in administration (although expected to come out of this successfully). The effect of P&O's decision to withdraw its Mostyn to Dublin service is not a direct effect of this merger – although, potentially, relevant to the counterfactual against which the merger should be assessed. Even excluding the Mostyn decision, however, the merger increases Stena's share of supply and the HHI concentration to an extent which may be expected to lead to a substantial lessening of competition.

The hybrid routes – with a destination in Northern Ireland but with a port of origin in the central corridor - may provide some competitive constraint on the central corridor routes. Of the five hybrid routes, Stena is acquiring one (Fleetwood-Larne) and of the others only the two operated by Norse Merchant Ferries appear to have some limited spare capacity. The inclusion of the hybrid routes as a competitive constraint appears to be insufficient to address the substantial lessening of competition in the supply of ferry services for freight in the central corridor.

Barriers to entry are theoretically low but in practice the fact that port facilities at Dublin and Belfast only have one vacant berth each limits the scope for entry. Barriers to expansion are lower, although it appears a significant increase in price would be required to trigger expansion. Larger freight operators may have some buyer power but it is unclear to what extent the reduction in spare capacity might limit choice. Moreover, bespoke pricing means smaller players are not protected at all.

The merger does therefore appear to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services.

UNDERTAKINGS IN LIEU

Having reached a reference conclusion the OFT may consider whether there might be undertakings in lieu of reference which would address the concerns outlined above. The parties did not propose any such undertakings.

DECISION

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