

Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland

ME/5677/12

The OFT's decision on reference under section 22(1) given on 21 January 2013. Full text of decision published 6 February 2013.

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

PARTIES

1. **Arriva Midlands North Limited (Arriva)** is a regional subsidiary of the European transport operator Arriva plc, which is itself owned by Deutsche Bahn AG. Arriva is active in the provision of registered local bus services in the Midlands. Of particular relevance to this case, Arriva has a bus depot in Cannock, Staffordshire, [WS11] (with 59 buses), and an 'outstation' at Hill Top, West Bromwich (11 buses).
2. **Liyell Limited (Liyell)** was a subsidiary of D&G Bus and Coach Limited, active under the trading name '**Midland**' in the provision of registered local bus services, primarily in the West Midlands but also in southern Staffordshire. It has a single depot in Wednesfield [WV13], near Wolverhampton, and a fleet of 61 buses. Liyell Limited's UK turnover in the year ending August 2011 was £4.8 million.

TRANSACTION

3. Arriva acquired the Midland operations and assets (including registered routes, 61 buses and employees) pursuant to a business and assets purchase (the **Transaction**). The consideration paid was £[], subject to certain adjustments.
4. Following announcement of the Transaction on 10 August 2012, an Office of Fair Trading (**OFT**) enquiry letter was sent on 7 September 2012. The

Transaction completed on 23 September 2012. The administrative deadline is 21 January 2013 and the statutory deadline is 20 February 2013.

5. Arriva submitted that the rationale for the Transaction was to expand its activities in the Centro region.¹

JURISDICTION

6. As a result of the Transaction, Arriva and Midland have ceased to be distinct. The OFT believes that the combination of assets acquired by Arriva is sufficient to constitute an 'enterprise' for the purposes of section 23 of the Enterprise Act 2002 (the **Act**).
7. The merged parties overlap in the supply of local bus services in the Cannock Urban Area and South Staffordshire. Arriva's share of supply is 79.8 per cent of weekly frequencies in the Cannock Urban Area and [50-60] per cent of passenger journeys in Staffordshire.² In both cases, there is an increment attributable to Midland. As such, the share of supply test in section 23(3) of the Act is met.
8. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

FRAME OF REFERENCE

9. The merged parties overlap in the provision of local registered bus services (commercial and tendered) and competition for tender contracts in Staffordshire (in the South, primarily in and round Cannock and Lichfield) and the West Midlands (Centro region).
10. The OFT and Competition Commission (**CC**) have each considered local bus service mergers on a number of occasions.³ In addition, on 20 December

¹ Centro, the West Midlands Integrated Transport Authority, is the organisation responsible for bus, rail and Midland Metro Tram transport in the West Midlands - see www.centro.org.uk

² Cannock Urban Area as identified by the Competition Commission in its market investigation report (Competition Commission, Local bus services market investigation, a report on the supply of local bus services in the UK (excluding Northern Ireland and London), 20 December 2011; www.of.gov.uk/OFTwork/markets-work/references/bus-services) and including the constituent settlements of Cannock, Burntwood, Great Wyrley and Norton Canes. [].

³ For example, OFT decision acquisition by Stagecoach of Eastbourne Buses and Cavendish Motor Services, 13 May 2009; CC report completed acquisition by Stagecoach Group Plc of Eastbourne Buses Limited and Cavendish Motor Services Limited, 22 October 2009; OFT

2011, the CC published the results of its local bus services market investigation, following a referral from the OFT on 7 January 2010.⁴

Product scope

Competition for tender contracts

11. Previous OFT and CC decisions (as well as the CC's local bus market report) concluded that competition for tenders should be analysed separately from the provision of local bus services, while taking into account that there may be some linkages between commercial and tendered services.⁵
12. The OFT's market investigation has not uncovered any evidence that contradicts this analysis. Therefore, the OFT assesses competition for tender contracts separately from the provision of commercial bus services, while taking into account that there may be some linkages between the commercial and tendered services.

Commercial and tendered bus services

13. In its local bus market report the CC found that commercial and tendered services can constitute alternatives from a demand-side perspective:

'For passengers, supported bus operations provide a service in the same way as they would for a commercial route. Indeed, on many supported routes passengers would be unaware that they are travelling on a tendered service. A passenger is therefore likely to substitute between supported and commercial bus services in those cases where they provide an alternative for the passenger's journey... We conclude that commercial and supported services are both part of the relevant markets for the provision of bus services.'⁶

14. The OFT has received no evidence in this case to suggest that this is not the case. Therefore, in line with previous decisions, the OFT assesses

decision acquisition by Go-Ahead plc of Arriva plc's (West Sussex) business, 16 November 2009; OFT decision acquisition by McGill's Bus Services Limited of the Arriva Scotland West local bus business, 18 April 2012 and OFT decision acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, 10 July 2012.

⁴ CC, Local bus services report (see footnote 2 above).

⁵ CC, Local bus services report, paragraph 7.120.

⁶ CC, Local bus services report, paragraph 7.114.

competition in the provision of all bus services, taking into account both commercial and tendered bus services.

Other forms of transportation

15. Arriva submitted that the product market should include any form of transport that is capable of taking an individual from point A to point B, such as private car or taxi. Arriva noted that for shorter journeys, the level of competition from bicycles and walking is expected to increase due to the cost of fuel and growth of the 'cycle to work' schemes.
16. Previous bus merger cases and the CC's Local bus services report considered the relevant product scope to include buses and, where relevant, rail has been considered to be a potential constraint on particular overlap flows. However, no other flexible forms of transport have been considered within the product scope.
17. The OFT has not received sufficient evidence to suggest that it should depart from previous cases. The OFT therefore assesses competition between bus services, taking into account any rail services where relevant.

Geographic scope

Competition for tender contracts

18. The OFT has previously considered the geographic frame of reference for tenders to be sub-national, based on the region where the tenders are offered.⁷ This is consistent with the CC's local bus market report which found that the market for tenders will generally include all bus operators in the local area. Accordingly, the OFT considers that the geographic frames of reference for competition for tenders in this case are primarily South Staffordshire and Centro (West Midlands), though may include certain neighbouring areas.

⁷ OFT decision, anticipated acquisition by Stagecoach Bus Holdings Limited of Islwyn Borough Transport Limited, 23 December 2009 and OFT decision, acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, 10 July 2012.

Commercial and tendered bus services

Flow level

19. In line with previous cases, the OFT has assessed the impact of the Transaction on a flow-by-flow basis, where a 'flow' is defined as a connection between two specific points. This approach is taken because passenger demand is for travel between two points. The assessment includes flows which have both their origin and destination within 500 metres of each other as the CC found these are likely to be demand-side substitutes, subject to the services having a sufficiently similar level of frequency and frequency distribution over time.⁸

Network level

20. In line with previous cases,⁹ the OFT considered whether it would be appropriate to assess the impact of the merger at a network level in addition to competition on specific point-to-point flows. However, given Midland's limited activities in Staffordshire (where, Arriva submitted, Midland derives only 12 per cent of its UK revenue) and Arriva's limited presence in the West Midlands where Midland is primarily active, the fact that National Express is the largest operator in the West Midlands, and that no third parties have raised any concerns, the OFT does not consider it necessary to conduct an assessment at a network level in this case.

Conclusion

21. The OFT considers, for the purpose of this assessment, the impact of the Transaction on:
- tender contracts in South Staffordshire and the Centro (West Midlands) region, and
 - commercial and tendered bus services on a flow-by-flow basis.

⁸ CC Report, completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009.

⁹ OFT decision, acquisition by McGill's Bus Services Limited of the Arriva Scotland West local bus business, 18 April 2012 and OFT decision, acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon and Cornwall Limited, 10 July 2012.

HORIZONTAL ISSUES

22. The OFT considers below firstly whether the Transaction will lead to a substantial lessening of competition for tender contracts such that future tender payments made by the authorities increase compared with the pre-merger market structure. Secondly, the OFT considers whether the Transaction results in a loss of competition on routes or flows such that fares for bus users on these routes/flows may increase post-merger or the competitive offering (such as frequency, quality of service or other non-price aspects) will be diminished.
23. Midland's depot is located in Wednesfield and the Centro (West Midlands) region accounts for 87-88 per cent of its business, with the remainder generated in South Staffordshire. Arriva's depot in the vicinity is in Cannock, Staffordshire. Whilst Arriva has a strong presence in Staffordshire ([50-60] per cent of passenger journeys in Staffordshire according to []), its presence in the West Midlands is small (Arriva submitted its share is less than three per cent based on information from Centro).
24. National Express is the largest bus services operator in the West Midlands. Other competitors in both the West Midlands and Staffordshire are discussed below where relevant.

Competition for tender contracts

South Staffordshire

25. As Midland has a depot in the West Midlands and is active in South Staffordshire, the OFT has focussed on bidding in South Staffordshire albeit that certain available data covers the whole of Staffordshire.
26. Arriva submitted that the average (mean) number of bidders in Staffordshire County Council (non-emergency) tenders¹⁰ was 4.63 taking into account all bids since June 2008 and was 4.93 if considering the period from January 2010. Arriva also noted that there are 21 other

¹⁰ Arriva explained that emergency tenders are short term tenders generally offered to cover an immediate, limited need. These are not included in the non-emergency figures.

registered local bus operators¹¹ and that any of these could bid for tenders in competition with Arriva in the future.

27. There are currently three other Staffordshire County Council tender operators in South Staffordshire: National Express, Cannock Cabs and Coastal Liner. However, the merged parties between them operate a substantial proportion of tendered services in South Staffordshire; Midland acquired a number of tender contracts when other operators were shut down by the Traffic Commissioner.
28. Further, bidding data for Staffordshire submitted to the OFT shows that in 2011, the numbers of bidders ranged from two to 12. There is evidence of limited numbers of bidders (only two or three) for some tenders in 2011 for services in South Staffordshire. The CC concluded that a low number of bidders in tenders for supported services reduced competition, based on evidence of a reduction in competitive pressure on pricing.¹²
29. Of 13 (non-emergency) tenders in 2011, Arriva won nine, Midland won two and Coastal Liner won two. In addition, the local bus tender data supplied by Arriva indicated that, with respect to emergency bids in 2010 and 2011 (which are only tendered to three operators), only Arriva and Midland were successful in their bids.
30. In addition, an Arriva internal document prepared in relation to the Transaction notes, amongst a list of benefits, that 'With reduced competition, our chances of bidding success increase'.¹³
31. The OFT considers that given the large proportion of tenders won by both Arriva and Midland in the most recent tender rounds, there is a prima facie competition concern that in removing an independent player active on a number of commercial and tendered routes in South Staffordshire, the Transaction may negatively impact intensity of competition on future tender rounds for supported services in South Staffordshire such that future tender payments made by the authorities increase compared with the pre-merger market structure.

¹¹ Located within 15 miles of Midland's depot.

¹² CC, Local bus services report, paragraph 13.44.

¹³ Annex 1B of 24 October 2012 submission entitled 'Acquisition of Midland Bus Company'.

Centro (West Midlands)

32. In the CC local bus services report, the Black Country case study indicated that there were a number of bidders for and operators of Centro tenders – an average of 4.8 bids per tender.¹⁴ Centro believes it has one of the highest average bus operator bidding numbers amongst transport authorities nationally and indicated that 16 operators are active on current tender contracts.
33. The evidence suggests that Arriva bid more actively and successfully in the Centro tendering round in February 2012 than previously. However, there is no indication that Midland was a particularly key or close competitor in this process. Furthermore, National Express and Diamond both appear to have successfully tendered for significantly more Centro supported services than Midland has.
34. Centro expressed no concerns about the impact of the Transaction on tendering. Given the tendering data and recent wins, the removal of one independent tender participant would not appear to raise concerns in relation to tendering for supported services in the Centro region. The OFT therefore finds that there is no realistic prospect of a substantial lessening of competition (**SLC**) in competition for tender contracts in Centro (West Midlands).

Commercial and tendered bus services: overlap flows

35. Arriva provided maps and data on all overlap flows between the merged parties. The OFT sought to identify services on which there were substantive overlap flows including those between commercial and supported services. As such, consistent with the CC's approach in McGill's/Arriva, the OFT did not consider further those routes for which overlap flows were limited to short distances.¹⁵ Overlaps arising solely between tendered services were also not considered further, given the merged entity's limited ability to adjust their passenger offer (fares, frequencies) on such services.

¹⁴ CC, Local bus services report, Appendix 6.4.

¹⁵ CC McGill's/Arriva report; Appendix F, paragraph 29(a).

36. On the basis of the above, the OFT identified seven routes (which include a number of overlap flows) on which to conduct its competitive assessment. These are set out in Table 1 below.

Table 1: routes assessed in more detail

A	Cannock-Burntwood-Lichfield
B	Walsall-Brownhills
C	Cannock-Hednesford
D	Walsall-Bloxwich
E	Wolverhampton-Perton
F	Wolverhampton-Wednesfield
G	Cannock-Wolverhampton

A: Cannock-Burntwood-Lichfield

37. Arriva operates service number 60, with two buses per hour, route distance of 21.5 km, and journey time of 50 minutes. A number of other Arriva routes overlap with part of the relevant Midland route (discussed below at paragraph 38) and the main ones are discussed separately below under Cannock-Hednesford.¹⁶
38. Midland operates service number 62, with one bus per hour, route distance of 25.1 km, and journey time of 56 minutes. The Midland service is operated using only two buses. There are also a small number of flows where the Arriva service 60 overlaps with Midland services other than route 62, in particular Midland service 23, which is also discussed below in relation to the Cannock-Hednesford route.
39. Both services run between Cannock Bus Station and Lichfield Bus Station. However, they take substantially different routes between Cannock and Burntwood, and therefore overlap only on a minority of intermediate flows, but then overlap on-road for most of the route section between Burntwood and Lichfield Bus Station (5.4 km). The flows on which the parties overlap account for approximately 50 per cent of [] the route.

¹⁶ Arriva services 835, 836 and 837 are buses for Stafford College operating one journey in each direction – given the discrepancy in frequency and the difference in purpose, this route is not considered to be competing with Midland route 62; Arriva services 2, 33a and 70 overlap on parts of the Midland route 62 but at different times and therefore are not considered to be competing. The overlaps with respect to routes 1 and 74 were minor.

40. There is a disparity between on-bus revenues for the routes, namely £[] for Arriva and £[less than 1/6th of Arriva's] for Midland. The Arriva service finishes much later in the evening than the Midland service. In addition to the difference in frequency this may help explain a disparity in route revenues between the two services.
41. Arriva submitted that competitors which overlap with Midland route 62 are National Express (service 10) and Cannock Cabs (tendered service T3 with two journeys per day twice a week). Given the discrepancy in frequency with Cannock Cabs and the fact that National Express' route overlaps with only a minor section of Arriva's route 60 (Chasetown and Travellers Rest Inn bus stops only), the OFT does not consider there to be an effective competitor to the merged parties on this route.
42. Given that Arriva and Midland run similar services and are the only two operators for 50 per cent of the Arriva route [], the OFT has prima facie competition concerns that Arriva may reduce frequency or increase fares on the overlap flows post-merger since it may be able to internalise any switching which would take place between the services.

B: Walsall-Brownhills

43. Midland's service 33 (Brownhills-Walsall) and Arriva's service 33 (Rugeley-Walsall) overlap fully between Brownhills and Walsall – a route distance of 13.1 km.¹⁷ National Express services 8 and 10/10A provide effective competition to the merger parties on a significant proportion of the relevant Brownhills to Walsall flows (where [] per cent of Arriva's route revenue is generated). Both National Express services run more frequently than the Arriva and Midland services.
44. Arriva also submitted that National Express runs a number of other routes overlapping on a number of flows (6, 7, 7a, 10a, 89/89a and 997), Black Diamond (Rotala) two (24, a tendered service, and 56) and Walsall Community Transport three tendered services. However, even if these were also considered to be competing, the Transaction results in a merger to monopoly over [] per cent of the route (based on revenue), which the OFT considers raises prima facie competition concerns that Arriva may

¹⁷ Arriva's services 8a and 23, both tendered services, also overlap on parts of the route but in one case runs at different times (evenings and Sunday only) and in another no revenue is generated where the merger parties' overlap suggesting they are not effective competitors.

reduce post merger frequency or increase fares on that part of the route since it may be able to internalise any switching which would take place between services.

C: Cannock-Hednesford

45. Two Midland services (62 and 23) serve this flow, each with a frequency of one bus per hour. Service 23 is a tendered service which takes an indirect route via the out-of-town Tesco Cannock superstore and has a longer journey time compared to the Arriva services.
46. Arriva operates two frequent circular services (25 and 26) between Cannock and Hednesford which between them provide 10 buses per hour. Three other longer distance Arriva services (31, 32 and 33) also serve this flow, together providing a further six buses per hour. The Cannock-Hednesford flow therefore has 16 Arriva services per hour to the two per hour for Midland.
47. In McGill's/ASW, the CC considered that '(a) a low-frequency service by either ASW or McGill's is unlikely to represent a significant change from the acquisition; and (b) a low-frequency service is less likely to constrain McGill's when these had high frequencies on the flow'.¹⁸
48. Arriva indicated that Cannock Cabs operates an infrequent tendered service (two journeys per day) between Cannock and Hednesford. However, the OFT considers that Cannock Cabs would not typically be regarded as an effective competitor to Arriva on the basis of the significant difference in frequency. There is also a quicker local rail service serving the flow running every half-hour and similarly priced to Midland and Arriva for the journey, although Cannock rail station appears to be a little more than 500 metres away from Cannock bus station.
49. Whilst other competitors are unlikely to offer effective competition, given the large disparity in frequency between the Midland and Arriva services, on balance, in this case, it seems unlikely that the infrequent Midland services will represent a competitive constraint on Arriva's frequent services on all overlap flows on this route such that it would be in the merged entity's interest to modify the competitive offering. The OFT

¹⁸ CC McGill's/Arriva report published 21 September 2012, Appendix F, paragraph 17.

therefore finds that there is no realistic prospect of a SLC on the Cannock-Hednesford route (including all overlap flows).

D: Walsall-Bloxwich

50. Midland service 19 overlaps on certain flows with Arriva services 1 and 2.¹⁹ However, there is effective competition from frequent National Express services (particularly service 29, but also services 301 and 302) on all relevant overlap flows. Therefore, the OFT is of the view that the Transaction has no significant impact on competition on all overlap flows on this route and therefore considers that there is no realistic prospect of a SLC on the Walsall-Bloxwich route (including all overlap flows).

E: Wolverhampton-Perton

51. Midland service 10 overlaps with certain Arriva (commercial and tendered) services which serve the region to the west of Wolverhampton. However, with respect to commercial routes 891 and 892 (Wolverhampton-Telford), Arriva does not generate any revenue on the overlap flows suggesting it does not actually compete with Midland on these routes.
52. Arriva submitted that routes 88 (Wolverhampton-Stafford), 516 and 517 (Wolverhampton-Pattingham) are tendered on a 'minimum cost' basis, such that Arriva does not gain a revenue benefit from any passengers that may divert from Midland's service. In addition, in the case of route 88, Arriva's revenues on the overlap flows are less than one per cent of the total route revenue. Arriva route 890 (Wolverhampton- Bridgnorth) also generates less than one per cent of its revenue where the merged parties overlap. Finally, routes 584 and 585 (Wolverhampton-Bobbington) are tendered, have a small overlap flow and different frequencies (Arriva only runs eight journeys a day where Midland operates a bus every half hour).
53. Given the above, the primary competition to the Midland route appears to come from National Express route 10, which has an equivalent frequency and overlaps almost entirely with Midland's service and the overlap flows. Therefore, the OFT is of the view that the Transaction has no significant impact on competition on all overlap flows on this route and therefore

¹⁹ Arriva also runs a tendered service 19 but it only operates on Sundays when Midland does not, therefore there is no actual competition between the two routes.

considers that there is no realistic prospect of a SLC on the Wolverhampton-Perton route (including all overlap flows).

F: Wolverhampton-Wednesfield

54. Midland service 18 (tendered) overlaps with Arriva services 560 (commercial) and 68 (tendered) on this major route corridor with a combined total frequency of four buses per hour.²⁰ However there are a number of National Express services (28, 59, 69, 89) that are at least as frequent as the Arriva 560 service, which runs every half hour, as well as a Black Diamond service (59) that also serves these flows. Therefore, the OFT is of the view that the Transaction has no significant impact on competition on all overlap flows on this route and therefore considers that there is no realistic prospect of a SLC on the Wolverhampton-Wednesfield route (including all overlap flows).

G: Cannock-Wolverhampton

55. Midland operates a tendered service 810, which overlaps on a small number of flows with Arriva services 70 (commercial; two per hour) and 68 (tendered; one per hour). However the Midland service only operates four journeys per day and appears to be a 'school transport' service. Therefore, given the large discrepancy in frequency, the infrequent Midland service does not appear to represent a substantive competitive constraint on Arriva's service such that it would be in the merged entity's interest to modify the competitive offering. The OFT therefore finds that there is no realistic prospect of a SLC on the Cannock-Wolverhampton route (including all overlap flows).

Barriers to entry and expansion

Competition for tender contracts

56. Arriva submitted that barriers to entry for tendered services are lower than for commercial services as a result of the guaranteed revenue stream from tender contracts. Arriva also argued that second-hand buses are readily available at low capital costs (including under rental agreements) and there are no significant capacity constraints or access restrictions for bus

²⁰ Midland also runs tendered service 28e but at different times to the Arriva services (evenings and Sundays).

stations or public highways in the Staffordshire County Council area. This, Arriva submitted, facilitates entry into the Staffordshire County Council tender contracts market by new or existing bus operators.

57. However, whilst there was some broad support in the CC Local bus services report for the arguments generally,²¹ the OFT also noted that in the last few years a number of bus operators supplying tendered services in South Staffordshire exited the market due to buses not being roadworthy. The OFT further received no evidence of planned entry to compete in tenders in Staffordshire County Council. The OFT is therefore of the view that entry may not be sufficiently timely or likely to counteract any concerns the OFT has with respect to competition for tender contracts in South Staffordshire.

Commercial and tendered bus services

58. Arriva submitted that barriers to entry are low, and that the biggest barrier to entry or expansion on a commercial basis is likely to be 'the dominance of the largest incumbent operator (National Express)...'. Third party competitor responses were mixed, one indicating that a large amount of capital is required to enter a market whereas another indicated there were not any meaningful barriers.
59. On the supply side, the CC market investigation found that the prospect of entry on commercial routes by operators that do not currently run directly competing services can impose a constraint on operators' behaviour in some circumstances. However, it considered this to be less of a constraint than head-to-head competition, and that the strength of the constraint was dependent on the nature of the potential entrant and on specific local circumstances.
60. Entry was considered, by the CC, a more effective threat from operators which already have a depot nearby and are operating services in or near the area concerned, or where the entrant is a larger operator relative to the size

²¹ CC Local bus services report, Chapter 13 (paragraphs 13.122 to 13.136 - note also: 'common with the commercial market, we find that there are some barriers to entry and expansion in the provision of tendered services, such as the sunk costs involved in establishing and enlarging operations (albeit that these are not found to be large) and bidding for contracts').

of the incumbent.

61. The CC did identify barriers to entry which may be relevant, in particular, in relation to commercial services. These included the risk that small scale entry may attract an aggressive response from the incumbent operator.
62. One third party indicated it has the ability to expand in the West Midlands and South Staffordshire but would need to consider a number of factors and another that it may try if the competitive offering were worsened in the West Midlands. However, it is not clear to what extent any entry or expansion would be timely, likely and sufficient to counteract any concerns raised.
63. Therefore, to the extent that the OFT has concerns on the Cannock-Lichfield and Walsall-Brownhills overlap flows, it is not apparent that new entry or expansion onto those flows would be timely, likely and sufficient to assuage the concern.

THIRD PARTY VIEWS

64. No third party expressed any concerns with the Transaction. A majority of third parties indicated that there was limited competition or overlap between the merged parties. A number (including a response to the invitation to comment) suggested that the Transaction might increase competition/be beneficial in the West Midlands with Arriva competing more effectively with National Express.
65. One third party expressed concerns at the low bids Arriva made for tender contracts. However, no merger effect has been identified from this and the OFT has assessed competition for tender contracts above.

ASSESSMENT

66. As a result of the Transaction, Arriva and Midland have ceased to be distinct. The share of supply test is met as the merger parties overlap in the supply of local bus services in the Cannock Urban Area and South Staffordshire, where Arriva's share of supply exceeds 25 per cent and the Transaction results in an increment to this share. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created as per section 23 of the Act.

67. The OFT considers that the relevant frames of reference are competition for tender contracts (in Centro and South Staffordshire) and commercial and tendered bus services (on overlap flows). The OFT did not consider it necessary to assess the network effects given the limited overlap between the merged parties' networks and lack of third party concerns in this respect.
68. The merged parties overlapped on a number of flows in South Staffordshire and the West Midlands. These are set out below with a summary of the OFT's findings in relation to each:
- Cannock-Burntwood-Lichfield – where they overlapped for passengers travelling from Cannock-Lichfield and en-route Burntwood-Lichfield with no other effective competitors on approximately 50 per cent of the route [].
 - Walsall-Brownhills – National Express is an effective competitor on most of the route but there is approximately [] per cent of the route where the Transaction results in a '2 to 1'.
 - Cannock-Hednesford – the difference in frequencies suggests that the merger parties were not effective competitors.
 - Walsall-Bloxwich – effective competition from National Express on the overlap flows.
 - Wolverhampton-Perton – no or limited revenue on overlap flows for a number of routes, a few routes tendered on a 'minimum cost' basis, difference in frequency for one route and presence of National Express running the same numbered service as Midland.
 - Wolverhampton-Wednesfield – other effective competitors on the overlap flows.
 - Cannock-Wolverhampton – difference in frequency suggests that the merger parties were not effective competitors.
69. With respect to competition for tenders, the OFT identified no concerns regarding the Centro (West Midlands) region given the tendering data and recent wins by National Express and Black Diamond. However, the OFT identified concerns with respect to South Staffordshire as Arriva and Midland appear to have won a significant proportion of the tenders in 2011.

70. The OFT is of the view that there are prima facie concerns, which it was not able to exclude, with respect to Cannock-Burntwood-Lichfield, Walsall-Brownhills and competition for tender contracts in South Staffordshire. The OFT therefore believes that there is a realistic prospect that the test for reference pursuant to section 22 of the Act may be met in this case. However, it was not necessary for the OFT to reach a definitive conclusion as to whether it is or may be the case that the merger may be expected to result in a SLC for the reasons set out from paragraph 71 below (that is, that it would in any event apply the markets of insufficient importance exception to the duty to refer).

EXCEPTIONS TO THE DUTY TO REFER: DE MINIMIS

71. The OFT has the discretion, pursuant to section 22(2)(a) of the Act, not to make a reference to the CC if it believes that the market(s) concerned is/are not of sufficient importance to justify a reference.

72. As the annual value of the affected market in this case is significantly less than £10 million (see paragraph 76 below), the OFT has considered whether it should apply the 'de minimis' exception. As the OFT's general policy is not to apply this exception where clear-cut undertakings in lieu of reference could be offered by the parties, the OFT has also considered whether such undertakings would be available if the duty to refer were met.

73. During the course of the investigation, Arriva informed the OFT that it would be willing to waive its procedural rights to a full investigation, including an issues letter and issues meeting, to the extent that the OFT was minded to apply the 'de minimis' exception to the duty to refer, and without prejudice to Arriva's views on whether the duty to refer was met. The OFT therefore did not send an issues letter to Arriva.²²

Availability of undertakings in lieu

74. As noted above, the OFT considered whether there was a clear-cut undertaking in lieu of a reference available in this case. The OFT notes that any behavioural remedies would not be considered clear-cut to address

²² See 'Mergers - Exceptions to the duty to refer and undertakings in lieu of reference guidance', December 2010, OF1122, paragraph 2.53.

competition concerns in this case in view of the risks regarding monitoring and enforcing, for example.

75. The OFT is of the view that the only structural remedy open to the parties to address the competition concerns in this case would be to reverse the Transaction. The OFT does not include what would amount to a prohibition of the merger when considering whether an 'in principle' undertaking in lieu is available.

Application of the 'de minimis' exception

76. The OFT calculated that the total size of the markets concerned (including the revenues where the merged parties overlapped and the Transaction resulted in a merger to monopoly for the Cannock-Burntwood-Lichfield and Brownhills-Walsall routes as well as the South Staffordshire tendering market) to be [under £1 million]. This included concessionary fares.
77. Thus, the annual value of the markets concerned is significantly below £3 million for which a reference to the CC would generally not be justified.²³ However, since the Transaction has resulted in a reduction of the number of effective competitors on some of the affected flows from two to one, mergers between bus companies may generally carry a high risk of replicability, and in view of the CC's report on local bus services in which it urged caution in applying the 'de minimis' exception in mergers of bus companies, the OFT has considered carefully whether the 'de minimis' exception should be applied in this case.
78. The OFT has therefore considered the facts of this case against the relevant criteria, namely the level of consumer harm taking into account the likelihood harm will arise, the magnitude of competition lost and duration of effects. The OFT has also considered replicability of the Transaction. The OFT has concluded that it is appropriate in this case to exercise its 'de minimis' discretion taking into account the following factors:
 - No third parties expressed concerns with the Transaction and a number of third parties noted that there was little competition between the merger parties suggesting that the magnitude of competition lost may not be high.

²³ 'Mergers - Exceptions to the duty to refer and undertakings in lieu of reference guidance', December 2010, OF1122, paragraph 2.15.

- The rationale of the Transaction was for Arriva to expand into the West Midlands, where it currently has a small presence. This is supported by internal documents²⁴ and the fact that only 12 per cent of Midland's revenue is derived outside the West Midlands in South Staffordshire. In addition, some third parties have indicated the Transaction will provide beneficial competition against National Express in the West Midlands. The OFT notes that the markets concerned in South Staffordshire accounted for the large majority of the revenues identified above under paragraph 76.
- Findings in previous bus mergers suggest that the risk of replicability is lower for competition in tender contracts than for commercial and tendered bus services (where there have been a number of SLC findings).
- The OFT has carefully considered whether exercise of the 'de minimis' exception in this case could give rise to the risks identified by the CC in its report on local bus services,²⁵ but it believes that this is unlikely in view of the specific facts of this case.

79. The OFT considers that the balance of factors set out above is in favour of the exercise of its 'de minimis' discretion. The OFT therefore considers that, to the extent that the duty to refer may be met, it would be appropriate to exercise its 'de minimis' discretion in this case.

DECISION

80. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.

²⁴ Annex 1B of 24 October 2012 submission entitled 'Acquisition of Midland Bus Company' and Annex 1C of 24 October 2012 submission entitled 'Project Saturn – Wednesfield Acquisition of assets – Liyell Limited, Update 8 August 2012'.

²⁵ CC Local bus services report, paragraph 15.357.