

# Completed acquisition by East Coast Buses Limited of the east coast operations of First Scotland East Limited

## Decision on relevant merger situation and substantial lessening of competition

**ME/6642-16**

The CMA’s decision on reference under section 22(1) of the Enterprise Act 2002 given on 23 January 2017. Full text of the decision published on 13 February 2017.

**Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.**

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### SUMMARY

1. On 14 August 2016, East Coast Buses Limited (**ECBL**), a subsidiary of Lothian Buses Limited (**LB**) acquired two bus depots and various other assets (collectively the **Acquired Assets**) comprising the east coast bus operations (**East Coast Bus Business**) of First Scotland East Limited (**FSEL**) from

FSEL, a subsidiary of First Group plc (**FirstGroup**) (the **Merger**). LB/ECBL (the **Acquirer**) and FSEL/FirstGroup (the **Seller**) are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that ECBL and the East Coast Bus Business have ceased to be distinct as a result of the Merger, that the share of supply test is met and that a relevant merger situation has been created.
3. The Parties both supplied commercial and tendered bus services in the Edinburgh, Midlothian and East Lothian areas prior to the Merger.<sup>1</sup> The Parties' bus operations in these areas were extensive, and overlapped to a significant degree across the routes they ran.
4. Based on the Parties' preliminary analysis, the CMA believes prima facie competition concerns may arise in the supply of local bus services on routes where the Parties overlapped pre-Merger. However, consistent with its approach in previous cases and given the circumstances that led to the Merger, the CMA considered it appropriate in this case to focus on the applicability or otherwise of an exiting firm counterfactual analysis. Given its conclusion on the exiting firm counterfactual, the CMA, did not consider it necessary to conduct an in-depth analysis in relation to local competition on the bus routes on which the Parties overlapped.
5. The Parties submitted that the correct counterfactual for the assessment of the Merger is that, absent the Merger: (i) the East Coast Bus Business would have exited the market; (ii) there were no less anti-competitive purchasers available; and (iii) if the East Coast Bus Business had exited the market, the majority of its customers would have diverted to the Acquirer.
6. Following detailed consideration of the evidence provided by the Parties and third parties, the CMA believes that, in the event that the Merger had not taken place:
  - (a) The East Coast Bus Business would have inevitably exited the market, such that there is no realistic prospect that FSEL would have continued operating this business. Prior to May 2016, FSEL's parent FirstGroup had been operating subject to undertakings which had been agreed between FirstGroup and the Secretary of State for Trade and Industry in 2002 (the **Undertakings**). The Parties submitted that these Undertakings imposed obligations, which had impeded FirstGroup's ability to restructure, cease

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<sup>1</sup> LB's operations do not extend beyond the Edinburgh, Midlothian and East Lothian areas. FSEL operations covered a wider geographic scope prior to the Merger.

or dispose of operations with respect to the East Coast Bus Business and its wider FSEL business, despite these businesses, particularly the East Coast Bus Business, being loss-making. Following a review, the CMA released FirstGroup from these Undertakings in April 2016. The Seller provided a number of internal documents which clearly showed that before the prospect of any sale to ECBL and as part of a wider necessary restructuring of the FSEL business:

- (i) The Seller had planned to cease the East Coast Bus Business operations if it was released from the Undertakings from early 2015.
  - (ii) The Seller had taken active steps to close and progress a sale of the Depots used for the East Coast Bus Business to a property developer.
  - (iii) Once it was released from the Undertakings, and prior to entering into any discussions with the Acquirer, the Seller had taken decisive action to cease the East Coast Bus Business.
- (b) Based on the evidence gathered during the course of its investigation, the CMA is confident that there was no less anti-competitive purchaser available for the East Coast Bus Business as:
- (i) Although FSEL did not formally market the East Coast Bus Business, the proposed closure of the East Coast Bus Business was actively publicized. The CMA's investigation indicated that in the context of this industry and the circumstances of the case, this publicity created extensive awareness that the East Coast Bus Business or assets relating to it could be bought, such that any less anticompetitive purchasers could have emerged.
  - (ii) In this context, aside from ECBL, one bus operator ([redacted]) made an offer, but this was considerably below the liquidation value of the Acquired Assets and the CMA is satisfied on the basis of the contemporaneous evidence that this offer would not have been increased to a level that was at or above liquidation value.
  - (iii) On a cautious basis, given the lack of formal marketing, the CMA also considered whether other operators may have made offers for the Depots had they been specifically marketed to them. In this context a single operator indicated that they were not aware the East Coast Bus Business or related assets could be purchased and that that they might have made a partial offer if they had known. However, the evidence available to the CMA did not indicate that there was a realistic prospect of such an offer above liquidation value.

(c) In the event that the Acquired Assets had exited the market, the CMA believes that the majority of sales made by the East Coast Bus Business would have transferred to the Acquirer. The Acquirer submitted detailed evidence indicating that it was well placed to introduce a very similar range of services to those previously offered by the East Coast Bus Business. On the basis of the evidence available from other operators, the CMA believes that it is not realistic that these operators would have had the ability to expand their services further or to such a degree that it would have prevented the majority of sales transferring to the Acquirer.

7. The CMA therefore believes that, in the absence of the Merger, the East Coast Bus Business would inevitably have exited the market, with no substantial replacement of the competitive constraint currently exerted on LB by this business.<sup>2</sup>
8. Therefore, relative to this counterfactual, the CMA believes that the Merger will not give rise to a realistic prospect of a substantial lessening of competition (**SLC**).

## **ASSESSMENT**

### **Parties**

9. ECBL is a wholly owned subsidiary of LB. LB's principal activity is the operation of commercial and tendered bus services in Edinburgh and the Lothians. Prior to the Merger ECBL was a dormant company owned by LB and therefore it does not have a turnover which is attributable to it. Edinburgh City Council is the majority shareholder in LB. The UK turnover of LB in the financial year ended 2015 was around £142 million.
10. FSEL operates commercial and tendered bus services in Edinburgh and East Lothian. FSEL is part of FirstGroup's bus division. The turnover of FSEL relating to the East Coast Bus Business in the financial year ended 28 March 2015 amounted to around £[~~142~~] million.

### **Transaction**

11. On 14 August 2016, ECBL acquired certain assets relating to FSEL's east coast bus operations from FSEL for a consideration of £[~~142~~]. The principal

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<sup>2</sup> The CMA considers this to be the case for both commercial and tendered services. It is clear to the CMA that it would have made no difference to the degree of competition for tenders in the area whether the Acquired Assets were owned by LB or had exited the market entirely.

assets that transferred to ECBL were a bus depot at Dalrymple Loan, Musselburgh (the **Musselburgh Depot**) and a satellite bus depot at Tantallon Road, North Berwick (the **North Berwick Depot**), collectively the **Depots**, as well as some plant and equipment, and fuel. A number of employees also transferred to ECBL under TUPE<sup>3</sup> as part of the Merger.

## Jurisdiction

12. The CMA considered whether it is or may be the case that enterprises have ceased to be distinct as a result of the Merger and in particular whether the collection of assets which have transferred to ECBL can be considered to form an enterprise. ECBL purchased the Depots as a going concern – the assets included property and employees, which transferred to ECBL under TUPE. Therefore, the CMA believes that it is or may be the case that the Acquired Assets constitute an enterprise for the purpose of consideration under section 23 the Act.
13. As a result of the Merger, the enterprises of ECBL and the East Coast Bus Business have ceased to be distinct.
14. The East Coast Bus Business's turnover for the year to 31 December 2015 was below £70 million. The turnover test set out in section 23(1) (b) of the Enterprise Act 2002 (the '**Act**') is therefore not met.
15. The Parties both supplied commercial and tendered bus services in Edinburgh, Midlothian and East Lothian and, following the Merger, LB now holds a share of approximately 90% of the supply of local bus services in this area.<sup>4</sup> Given that these three areas are contiguous, taken together, the CMA considers that it is or may be the case that this area constitutes a substantial part of the UK for the purposes of section 23 of the Act. The share of supply test in section 23(4) of the Act is therefore met.
16. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 15 December 2016 and the statutory 40 working day deadline for a decision is therefore 14 February 2017.

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<sup>3</sup> Transfer of Undertakings (Protection of Employment) Regulations 2006, SI 2006/246.

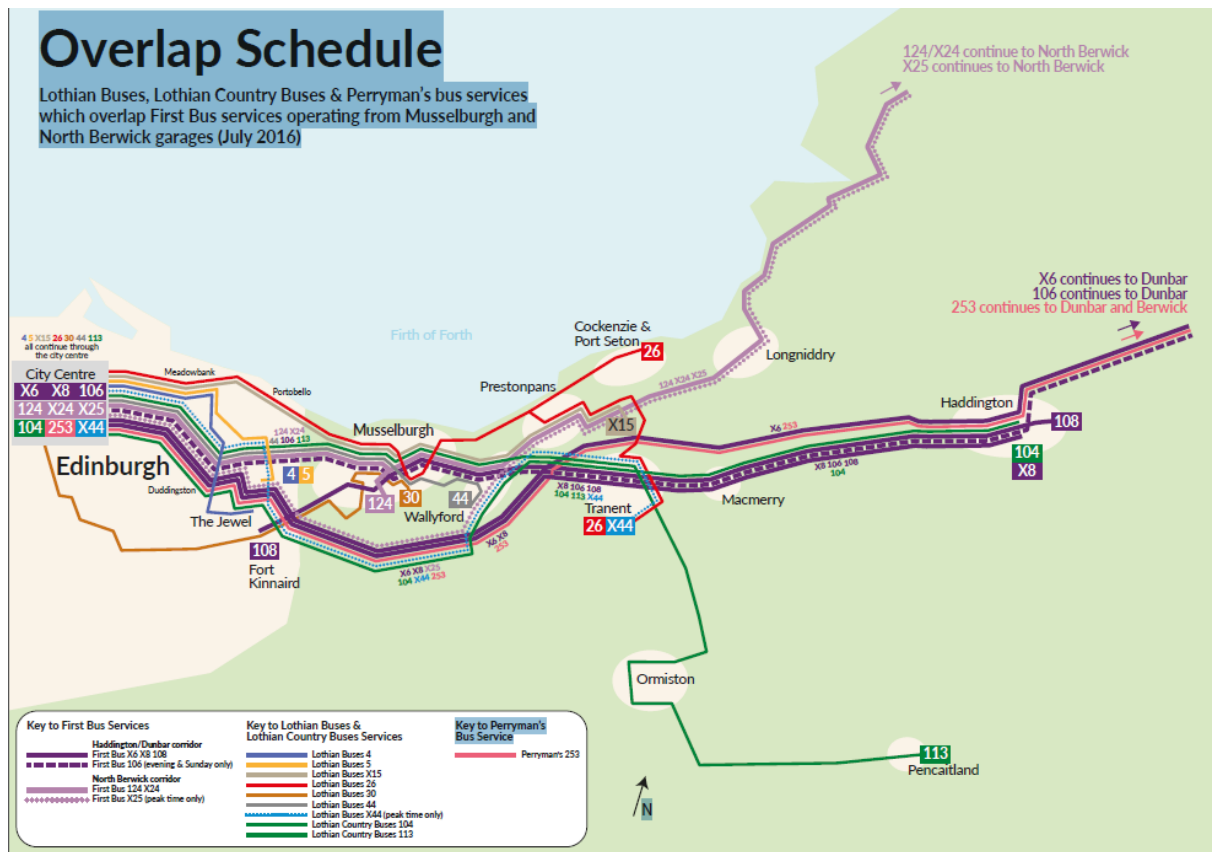
<sup>4</sup> LB's pre-merger share of supply was approximately 87.3%, based on the unweighted average of registered mileage in these three areas in 2015. Shares for individual local authority areas were as follows: City of Edinburgh, 89%; Midlothian, 84%, East Lothian, 89%.

The source for this is Traveline Data supplied by FirstGroup to the CMA for the Review of Undertakings. FSEL's share of supply in East Lothian, where the Depots are located, was 9%. Attributing the vast majority of this to LB after the merger gives a share of supply in the three unitary authorities of approximately 90%.

17. The Merger completed on 14 August 2016. The four-month deadline for a decision under section 24 of the Act is 28 February 2017, following an extension under section 25(2) of the Act.
18. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

## Background and rationale

19. The Parties both supplied commercial and tendered bus services<sup>5</sup> in the Edinburgh, Midlothian and East Lothian areas.<sup>6</sup> The Parties' bus operations were extensive in these areas, overlapping to a significant degree across the routes they ran in the East of Edinburgh and East Lothian, as can be seen from the map below.



<sup>5</sup> Local bus services are typically provided either on a commercial or on a tendered basis. (i) Commercial services are subject to registration with the relevant local traffic commissioner but subject to this bus providers are free to set all aspects of their offering (including routes, fares and service levels). (ii) Tendered services are commissioned on a tendered basis and operators compete to be the provider for a set route. These often cover journeys that a local transport authority considers would be unlikely to be provided on a commercial basis.

<sup>6</sup> The Edinburgh, Midlothian and East Lothian areas cover the extent of LB's operations. FSEL operations covered a wider geographic scope prior to the Merger.

20. In Edinburgh, LB operated 89% of registered mileage, and FSEL 2%. In Midlothian LB and FSEL operated 84% and 15% of the registered mileage respectively, while in East Lothian, LB and FSEL operated 89% and 9% of the registered mileage respectively.<sup>7</sup>
21. Based on the Parties' preliminary analysis, the CMA believes prima facie competition concerns may arise in the supply of local bus services on routes where the Parties overlapped pre-Merger. However, consistent with its approach in previous cases and given the circumstances that led to the Merger, the CMA considered it appropriate in this case to focus on the applicability or otherwise of an exiting firm counterfactual analysis. Given its conclusion on the exiting firm counterfactual, the CMA, did not consider it necessary to conduct an in-depth analysis in relation to local competition on the bus routes on which the Parties overlapped.

## Counterfactual

22. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For completed mergers the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the Merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.<sup>8</sup>
23. As set out in the CMA's Merger Assessment Guidelines, for the CMA to accept an exiting firm scenario in this case, it would need to believe that the following conditions were met:
  - (a) On the basis of compelling evidence it was inevitable that the East Coast Bus Business would exit the market (limb 1);
  - (b) There was no substantially less anti-competitive purchaser for the business or its assets (limb 2); and

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<sup>7</sup> Appendix 1 of Review of FirstGroup Undertakings. Figures relate to 2015.

<sup>8</sup> *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

- (c) The Merger does not represent a substantially less competitive outcome compared with what would have happened to the sales of the business in the event of its exit (limb 3).<sup>9</sup>
24. The Parties submitted that the correct counterfactual for the consideration of the acquisition of the East Coast Bus Business should be that, absent the Merger:
- (a) The Depots would have ceased to operate as bus depots and the routes operating from the Depots would have been terminated such that the East Coast Bus Business would have exited from the supply of bus services in East Edinburgh and East Lothian due the need for restructuring of the wider FSEL business and the ability of FirstGroup to do this as a result of the Undertakings being lifted;
  - (b) There would have been no alternative less anti-competitive purchaser as the Depots would have been sold to a property developer;
  - (c) ECBL would have registered a suite of routes which were very similar to those being operated by FSEL whether or not they purchased the East Coast Bus Business such that the Merger itself would have little effect on competition.
25. The CMA has carefully considered a range of evidence in order to reach its conclusions on each of these limbs and sets out this evidence and its views below.

***Limb 1 - Would the East Coast Bus Business inevitably have exited the market absent the Merger?***

26. The CMA notes that in the present case the business under consideration for the purposes of the counterfactual is part of a larger corporate group.<sup>10</sup> Consistent with its guidance and decisional practice on exiting firm counterfactuals, the CMA has therefore carefully considered whether the Seller would inevitably have closed the East Coast Bus Business, by reviewing:

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<sup>9</sup> [Merger Assessment Guidelines](#), see paragraph 4.3.10.

<sup>10</sup> Paragraph 4.3.15 of the [Merger Assessment Guidance](#) explains that the exiting firm scenario applies where the firm is failing financially. It may also apply to a subsidiary or division of a larger corporate group (as is the case here) where the subsidiary or division is genuinely loss-making and the parent decides to close it down.



- (a) Evidence on the Seller's rationale, including the necessity of ceasing these particular operations.<sup>11</sup>
  - (b) Evidence on plans and steps taken to cease the operations.
  - (c) Evidence on the extent to which these plans were influenced by the possibility of a Merger with the Acquirer.
27. The CMA considered a range of evidence in this context, including from contemporaneous documents, such as board minutes, management accounts and strategic plans. In assessing whether FSEL's exit from the East Coast Bus Business was envisaged independently of the Merger, the CMA took account of the dates of such documents and in particular whether they were prepared prior to the contemplation of the Merger.

*Seller's rationale for exiting the East Coast Bus Business*

28. The Parties submitted that prior to May 2016, as explained above in paragraph 6a, FirstGroup had been operating subject to Undertakings, which affected its East Coast Bus Business. The Undertakings required FirstGroup not to raise bus fares in excess of a specified index and to operate a 'mileage floor' such that the FirstGroup could not reduce mileage below 75%<sup>12</sup> of the mileage that it had operated in 2002.
29. The Parties submitted that the FSEL business had been loss-making for a number of years but the Undertakings had impeded FirstGroup's ability to restructure, cease or dispose of its East Coast Bus Business or its wider FSEL business.
30. As such, FirstGroup conducted a detailed review of how it could improve its operations if the Undertakings were lifted. This review showed that cutting loss-making routes, closing loss-making depots and restructuring the fares would allow the FSEL business to grow again. In that context, the East Coast Bus Business was the worst performing part of the FSEL business in that [✂] per cent of the losses at FSEL were attributable to the bus routes operating from the East Coast Bus Business, but the business itself only accounted for only 8 per cent of its bus fleet. The Depots and associated operations were therefore identified as needing to close.

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<sup>11</sup> Paragraph 4.3.9 of [Merger Assessment Guidelines](#) explains that a business or a division of a business can exit for strategic reasons.

<sup>12</sup> Originally 95%, reduced to 75% in 2008.

31. In summary, the Parties submitted that restructuring was necessary for the continuing viability of the wider FSEL business, and exiting the East Coast Bus Business was the most rational solution in that context.
32. As detailed below, the CMA notes that the evidence available from a detailed review of financial information, contemporaneous documents and submissions from the Review of Undertakings strongly supports the Parties' submissions that (i) the FSEL business was suffering losses; and (ii) restructuring was necessary and this might be possible after the Undertakings were lifted such that closing the Depots offered the most rational restructuring solution.

#### *FSEL's financial performance*

33. Evidence gathered by the CMA in the course of its Review of Undertakings indicated that FSEL had been loss making for the previous four financial years despite repeated efforts by FirstGroup to turn the operations around within the constraints of the Undertakings. The annual report and financial statements for FSEL indicate that it was making operating losses over the two years ended April 2015. Its net liabilities as at 28 March 2015 were £4 million, up from £2.6 million as at 29 March 2014.
34. Evidence from the Seller's internal documents also shows that the Depots were regularly the worst performers and largest source of losses at FSEL. For example:
  - (a) FSEL's board report of January 2016 showed a year to date operating loss of £([REDACTED]) at Musselburgh<sup>13</sup> and earnings before interests and tax (EBIT) at Musselburgh of £([REDACTED]), and indicated that Musselburgh was the worst performing depot in the FSEL business.<sup>14</sup>
  - (b) A FirstGroup document from April 2016 analysing the FirstGroup bus business further confirmed that Musselburgh continued to perform poorly and worse than other depots in the FSEL business.<sup>15</sup>

#### *Closure of East Coast Bus Business considered necessary*

35. From early 2015, FirstGroup carried out a detailed exercise to identify measures that could be taken to restore the FSEL business to profitability if the Undertakings were lifted. Subsequently, from April 2015, FirstGroup's

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<sup>13</sup> References to Musselburgh include the North Berwick Depot as its satellite.

<sup>14</sup> [REDACTED] – 24 January 2016, page 21 (Confidential Document 12).

<sup>15</sup> FirstGroup's UK Bus: [REDACTED] dated April 2016 (Confidential document 20), page 66.

internal documents prepared for board meetings and other senior discussions regularly highlighted that depot and associated route closures were necessary to the wider viability of the FSEL business and specifically identified the East Coast Bus Business as an area where such closures should be implemented. In particular:

- (a) In early 2015, prior to FirstGroup's formal request for the Undertakings to be reviewed, FirstGroup conducted a review of FSEL to decide what to do with the business if the mileage floor and price cap were removed. A FirstGroup internal document setting out the analysis of this review from May 2015, concluded that any unprofitable route would be stopped and, on that basis, Musselburgh and North Berwick should be closed.<sup>16</sup>
- (b) An internal document produced for FirstGroup's board in April 2015 analysing FirstGroup's bus businesses in detail indicated that rationalisation was necessary for the improvement of the FSEL business, stating that: 'Mileage now at the minimum allowed by SBH Undertakings' and that 'top actions to improve' included '[r]ationalisation of depots as part of the SBH undertakings review.'<sup>17</sup>
- (c) A FirstGroup board document from May 2015 confirmed the internal analysis referred to at (a) above and noted that 'FSEL has been a prolonged poor financial performer despite repeated attempts to resolve' and that therefore it was indented for the Musselburgh and North Berwick Depots to close if FirstGroup is released from the Undertakings.<sup>18</sup>
- (d) FSEL's strategy/five-year plan document dated September 2015 predicted that FSEL would operate at a loss in 2015/16 but that future years were expected to be profitable;<sup>19</sup> due to the restructuring planned when the Undertakings were lifted which would '[redacted]'.<sup>20</sup>
- (e) A FSEL board report dated 22 March 2016, confirmed that: '[redacted]'.<sup>20</sup>

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<sup>16</sup> Project Siobhan, Central Finance Team Review, 18 May 2015.

<sup>17</sup> FirstGroup's UK Bus – 'Deep Dive: Achieving the 2015/16 Target' dated 9 April 2015 (Confidential Document 3), pages 3 and 7.

<sup>18</sup> FirstGroup UK Bus – Deep Dive, 21 May 2015.

<sup>19</sup> FSEL strategy/five-year plan dated September 2015, page 25. This indicated an operating profit of £ ([redacted]).

<sup>20</sup> Scotland East P12 Performance Pack for the period 22/02/16 to 22/03/16 (Confidential Document 16), at page 4.

- (f) A FirstGroup board business review document from April 2016 noted that the Musselburgh Depot would close as part of the proposals to restructure the FSEL business after the Undertakings were lifted.<sup>21</sup>
- (g) As part of the final approval process for the closure of the East Coast Bus Business, an email exchange between the Seller's senior business managers on 10 May 2016,<sup>22</sup> contained projections of the EBIT and margin improvements that could be achieved as a result of the plans to close the East Coast Bus Business.

36. For the reasons set out above, the CMA believes that the Seller has provided evidence that clearly indicates that it wanted to close the East Coast Bus Business to ensure the longer term viability of the FSEL business.

*Steps taken to close and dispose of the East Coast Bus Business absent contemplation of the Merger*

37. The CMA considered the extent to which the proposals for exiting the operations of the East Coast Bus Business had been progressed prior to and independently of discussions regarding the Merger.
38. The evidence available to the CMA indicates that the East Coast Bus Business would have closed absent the Merger and the Depots would have been sold to a property developer. Internal documents, produced by FirstGroup prior to any consideration of the Merger confirm that:
- (a) As noted above, all plans to restructure the FSEL business by closing the East Coast Bus Business pre-dated any discussions with the Buyer, which began only after the Seller's public announcement that the East Coast Bus Business would close on 24 May 2016.
  - (b) Ahead of the public announcement indicating that the East Coast Bus Business would close and the routes it operated would cease, FirstGroup was progressing plans for the Depots associated with the East Coast Bus Business to be sold to a property developer. Specifically;
    - (i) FirstGroup contacted [redacted] (a [redacted] which had shown an interest in purchasing the Depots in the past) to inform them that it was considering selling the Depots in the event that it was released from the Undertakings in late February 2016. The Seller submitted that it

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<sup>21</sup> The FirstGroup UK bus business review 2015 period 12 notes (page 66) that Musselburgh which was expected to have a 2015/16 EBIT of £[redacted] and a 2016/17 budgeted EBIT of £[redacted] would close as part of the proposal to restructure the business and that the expected savings from this would be £[redacted].

<sup>22</sup> Email from [redacted] to [redacted] dated 10 May 2016 at 21:56, with 'Full year post-Siobhan EBIT by depot' analysis attached.

decided to engage with [X] on an 'off-market' private and confidential basis. This was preferred to a public marketing of the properties in light of the internal and external sensitivities around the potential closure of the Depots, which at that time had been neither confirmed nor made public. [X] were chosen due to their previous interest and a proven ability to deliver based on a successful sale of other property.

- (ii) On 16 March [X] emailed the Seller to indicate a willingness to pay £[X] for Musselburgh and £ [X] for North Berwick.<sup>23</sup>
  - (iii) On 15 March 2016, CMA provisionally decided to release FirstGroup from the Undertakings. The Seller submitted that 'from at least April 2016' (ie following the CMA's provisional decision to release the business from the Undertakings and after the initial offer from [X]) active consideration was being given to the logistics of closing and the disposal of the Depots. A FirstGroup board document from April 2016 set out the intention to progress and the plan that would be followed to effect the sale of the Depots to [X] for property development.<sup>24</sup>
  - (iv) Following this, [X] submitted heads of terms with respect to their offer on 19 April 2016 with a view to converting the buildings into [X].
- (c) Once the CMA had issued its final decision to release FirstGroup from the Undertakings on 20 April 2016, FirstGroup reached a final decision to close the Depots on 11 May 2016<sup>25</sup> and took the necessary steps for announcing this on 24 May 2016, which as noted above was ahead of any engagement with the Buyer with regard to a potential sale.

### *Conclusion on limb 1*

39. The evidence above clearly shows that, as part of its restructuring plans, FirstGroup had planned to close its East Coast Bus Business for some time preceding consideration of a sale of it to the Acquirer. Even before it had been released from the Undertakings, FirstGroup had taken steps to effect the exit of the East Coast Bus Business through the sale of the Depots to a property developer. It is clear that these steps were decisive and had been taken independently of any consideration to sell to the Acquirer. The CMA is therefore confident, based on all the above mentioned factors, that there is compelling evidence that the first limb of the exiting firm test is met, ie the

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<sup>23</sup> Confidential Document 16.

<sup>24</sup> FirstGroup's '[X]' 2015/16, April 2016 (Confidential Document 20).

<sup>25</sup> Telephone call between the managing director of FSEL and divisional director of First Bus following the circulation of an email of 10 May assessing the financial impact of closures.

inevitable market exit of the East Coast Bus Business absent the Merger with no serious prospect of re-organization.

***Limb 2 - No substantially less anti-competitive purchaser for the East Coast Bus Business or its assets***

40. As set out in its Guidance,<sup>26</sup> even if the CMA believes that the firm would have exited, there may be other buyers whose acquisition of the firm as a going concern, or of its assets, would produce a better outcome for competition than the merger under consideration.
41. When considering the prospects for an alternative buyer for the firm or assets, the CMA will look at available evidence supporting any claims that the merger under consideration was the only possible merger. The CMA will take into account the prospects of alternative offers above the liquidation value.<sup>27</sup>
42. Therefore, in order to come to a view on whether there was an alternative purchaser which would have presented a less anti-competitive alternative to ECBL, the CMA has considered evidence on: (i) the sales process and associated awareness of the availability of the Acquired Assets (ii) what would have been a realistic purchase price for the East Coast Bus Business or the relevant Acquired Assets taking a view on the liquidation value of the Acquired Assets; (iii) in that context, an assessment of actual or potential alternative offers, for the purposes of determining whether there was a realistic prospect of a less anticompetitive purchaser.

***Marketing of the Acquired Assets to alternative purchasers***

43. As explained in paragraph 38(a), the Seller submitted that some time prior to the release from the Undertakings, FirstGroup had taken steps to market the Depots for sale through an estate agent and had received a firm expression of interest from a property developer. Therefore, at the point at which it was released from the Undertakings, FirstGroup was already aware of a potential purchaser for the Depots. Once it was released from the Undertakings, FirstGroup continued to make plans to advance a sale with a property developer but did not market the Depots or the East Coast Bus Business more widely, including to Lothian Buses.
44. Although there was no formal marketing of the Depots, the fact that they were due to be closed was publicly announced by FirstGroup on 24 May 2016 and widely reported in the media, including in the Scottish press and in specialist

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<sup>26</sup> See paragraph 4.3.16, [Merger Assessment Guidelines](#).

<sup>27</sup> MAGs, paragraphs 4.3.16 to 4.3.17.

bus industry publications. The articles began appearing on announcement of the closures on 24 May 2016.

45. In general, the absence of a formal marketing process to in-market buyers will make it difficult for the CMA to satisfy itself at Phase 1 that there is no reasonable prospect of a substantially less anti-competitive purchaser,<sup>28</sup> and accordingly the CMA has considered all of the available evidence with particular scrutiny. In particular, the CMA has considered the extent to which: (i) the wide publication of the upcoming closure the East Coast Bus Business created sufficient awareness that the assets could be bought, such that any less anticompetitive purchasers could have emerged; and (ii) whether, in any case, on a cautious basis, there is any evidence of any potential purchasers who did not make an offer because they were not specifically marketed to. Where this is the case, the CMA has assessed the prospect of there being an alternative less anticompetitive purchaser further.

*Awareness of implications of closure of the East Coast Bus Business*

46. The CMA has conducted extensive enquiries with potential purchasers of the assets, including a range of in-and-out of area bus operators. These extensive enquiries indicated that all local bus and coach operators that the CMA contacted in Edinburgh and the Lothians, including all larger operators, were aware that the Depots were closing and that all but one understood that the assets might be available to purchase on that basis.<sup>29</sup> Following its contacts with third party bus operators, the CMA believes that most competitors that might have had an interest in purchasing the East Coast Bus Business or Depots were aware that the announcement implied that the Acquired Assets were available for purchase, thereby creating an opportunity for entry/expansion. In this context, the CMA notes that FirstGroup received a number of expressions of interest from bus operators and other parties as a result of its announcement.
47. In the circumstances of this case, the CMA is therefore satisfied this publicity created extensive awareness within the bus industry (and outside it) of the availability of the Acquired Assets such that any interested and potentially substantially less anti-competitive alternative bus operator could have expressed an interest in purchasing them.

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<sup>28</sup> See, for example, OFT decision on the anticipated acquisition by Stagecoach Group Plc of the North Devon business and assets of First Devon And Cornwall Limited, published 28 August 2012, paragraphs 26 to 34.

<sup>29</sup> One small operator indicated that it was aware of the planned closures but did not assume that the Depots might become available for sale as a result.

### *Other potential offers*

48. However, on a cautious basis and consistent with decisional practice,<sup>30</sup> given the lack of a formal marketing process, the CMA has considered whether other operators may have made offers for the Depots, had they been specifically marketed to them.
49. Having contacted other operators both in and out of the local area, the CMA is aware that a single bus operator had not been aware that the announcement implied an opportunity to buy some or all of the Acquired Assets, and on a cautious basis has also considered whether this operator could have been a substantially less anti-competitive purchaser. Otherwise, based on the responses from other operators, the CMA has found no evidence to suggest that any other local bus operators would have made offers approaching the liquidation value, even considered on a cautious basis given the absence of formal marketing.

### *Liquidation value of the Acquired Assets*

50. In evaluating the credibility of offers made by other bus operators, the CMA uses the liquidation value of the Acquired Assets as the benchmark against which to compare the offers.<sup>31</sup>
51. In the present circumstances, the CMA believes that the starting point for estimating the liquidation value of the Acquired Assets is the amount that FSEL would have received from selling the Depots to the property developer it contacted in February 2016 (see paragraph 38(b)(iv)), as this benchmark was established through a normal commercial process at a time when the Merger was not in contemplation and can therefore be considered to be a fair valuation of the assets. In this case, FSEL was in receipt of an offer of £ [X] million.
52. In establishing the liquidation value of the Acquired Assets (as opposed to the Depots only), the CMA took into account other considerations. In particular:
  - (a) If it had accepted this offer, FSEL would have incurred substantial redundancy costs associated with the laying off of staff – it estimated that this would have cost approximately £[X].

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<sup>30</sup> See case ME/5043/11 anticipated acquisition by [Kingfisher plc of 30 stores from Focus](#) (in Administration) and case ME/5765/12, anticipated acquisition by [Sports Direct International plc of 19 stores from JJB Sports plc](#) (in administration).

<sup>31</sup> See paragraph 4.3.17 of [Merger Assessment Guidelines](#).



- (b) The Acquirer purchased other assets (plant and equipment and fuel), which are valued at £[REDACTED].
  - (c) Completion of the sale to [REDACTED] was conditional on receiving planning permission for a change of use for the Depots for residential property development. [REDACTED] may not therefore have been in a position to complete the transaction until around March 2017.
  - (d) FirstGroup explained that there would be a reputational cost to closing down services and making redundancies, as would have been implied by a property sale.
53. Therefore, the CMA considers that in this case, the appropriate liquidation value of the Acquired Assets is the value of the Depots for redevelopment, adjusted to take account of the redundancy costs that FSEL avoided by selling to a bus operator and applying a discount factor to take account of the risk associated with planning permission not being granted to the property developer; the reputation cost of closing down routes; as well as the liquidation value of the other assets purchased by the Seller. The CMA estimates that this would have been less than £1 million.<sup>32</sup> It is difficult for the CMA to make a precise estimate for the lower bound of the liquidation value in this case, but the CMA considers that it is unlikely to be significantly less than the offer made by the Acquirer (ie £[REDACTED]).

#### *Assessment of actual and potential alternative offers*

54. As noted above, the Seller received expressions of interest for the Acquired Assets from the Acquirer and one other bus operator on announcing it was to close the East Coast Bus Business. The CMA contacted all the other bus and coach operators in the Edinburgh and Lothian areas that it was aware of, and understands that one small bus operator would also have been interested in making an offer for North Berwick only, had it realised that the fact that the East Coast Bus Business was closing implied that the Sellers were open to offers.
55. The CMA has considered both the actual and potential alternative offers in the context of: (i) the liquidation value above; and (ii) evidence relating to these operators ability to purchase the assets, to determine the extent to which there was a realistic prospect of a substantially less anti-competitive purchaser.

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<sup>32</sup> This figure does not take account the value of FSEL's bus fleet operating from the Depots which were valued at between approximately £[REDACTED] million and £1 million. These were not included in the purchase by ECBL.

*Actual offer received by FSEL*

56. [X] submitted that on seeing the announcement that FSEL was intending to close its East Coast Bus Business, it understood that the East Coast Bus Business would be available for sale. It therefore made an offer to FSEL to purchase the East Coast Bus Business on 25 May 2016. [X] offered £[X] for the Musselburgh Depot and £[X] for the North Berwick Depot. For the employees associated with the Depots and the assets contained within the Depots, all the vehicles at the Depots and the goodwill for the commercial routes, [X] offered £[X]. [X] offer for the Acquired Assets therefore amounted to approximately £[X] minus the value of the bus fleet associated with the East Coast business, which could have otherwise been redeployed by the Seller in other parts of its business and as such it was equivalent to a negative valuation of the Acquired Assets.<sup>33</sup>
57. This was significantly lower than any plausible estimate of the liquidation value and therefore unrealistic.
58. FirstGroup submitted that the offer it received from [X] was unacceptable in absolute terms (and not simply in comparison to the Acquirer's offer) because it was well below an amount it would have received had it proceeded with a sale to [X] and what the Seller had offered. [X] received an email from FirstGroup on 27 May 2016 informing it that its offer had been unsuccessful. There was no further engagement between it and FirstGroup after this point and [X] did not seek to understand why its offer was unsuccessful or if it could improve its offer.
59. On a cautious basis, the CMA considered whether – in the absence of the Acquirer's offer – [X] may have increased its offer to above the liquidation value.
60. In response to the CMA's enquiries, [X] indicated that it would have [X] if it had been provided with an opportunity to do so, but it was unable to provide any contemporaneous evidence in support of its contention.
61. In view of [X] failure to take any steps after receiving the email of 27 May 2016, lack of any evidence indicating that it could and/or would have increased its offer and of the magnitude of increase that would have been necessary for [X] offer to reach a level equivalent to the liquidation value of the Acquired Assets, the CMA believes [X] was not a realistic alternative purchaser.

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<sup>33</sup> As noted above, these were valued at £[X] million. Taking the lower bound estimate, [X] offer amounted to £[X].

### *Potential offer*

62. As noted above, on a cautious basis, the CMA has considered whether there was a realistic prospect of an alternative purchaser among the operators who had not been specifically marketed to due to the absence of a formal marketing process. As discussed, only one small local bus operator told the CMA that it might have been interested in making an offer but only for the North Berwick site which is a satellite of the main Musselburgh depot, had it made the connection that the announcement of the closure of the Depots would have meant they might have been available for purchase.
63. However the CMA does not believe that this operator should be considered as offering a realistic prospect of being a less anti-competitive purchaser as the operator's estimate of the value to it of the depot alone (without the employees associated with it) would have fallen considerably below the liquidation value of the property.<sup>34</sup>
64. Therefore the CMA does not believe that a sale of one or both of the depots to a bus operator should be considered as constituting a realistic counterfactual.

### *Conclusion on limb 2*

65. For the reasons set out above the CMA is satisfied that there were no realistic alternative substantially less anticompetitive purchasers for the Acquired Assets.

### ***Limb 3 - What would have happened in the event of the exit of the Acquired Assets?***

66. The CMA's Guidelines indicate that where it believes that a firm and its assets would have exited, it will consider what would have happened to the sales of the firm. It will consider whether sales would have been redistributed among the firms remaining in the market and, if so, how. If sales were likely to have been dispersed across several firms, the merger, by transferring most or all of the sales to the acquirer, may have a significant impact on competition. If, on the other hand, the majority of the sales were expected to have switched to the acquiring firm, the merger may have little effect on competition.<sup>35</sup>

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<sup>34</sup> The CMA notes that this operator has been looking for a depot, as it currently has insufficient capacity to run its existing services. It told us that, if it had bought the Berwick depot, it would have used it to maintain its current services. Therefore even if this purchase had proceeded it would not have led to sales diverting to this purchaser and therefore it would not have led to a less anti-competitive outcome.

<sup>35</sup> See paragraph 4.3.18 of the CMA's [Merger Assessment Guidelines](#).

67. As noted above, the CMA has received compelling evidence that absent the Merger, the East Coast Bus Business would have closed and that its assets would no longer have been used to operate bus operations whether by the Acquirer or other bus operators.
68. In this context, the CMA has assessed whether and to what extent the sales from the East Coast Bus Business' routes would have been captured by other operators, by considering the extent to which: (i) the Acquirer would have operated tendered and commercial routes in the East of Edinburgh and East Lothian areas in the absence of the Merger, and (ii) other bus operators would have entered or expanded in this geographic region had the Merger not taken place.
69. The evidence available to the CMA indicates that the majority of sales from the East Coast Bus Business would have transferred to the Acquirer even absent the Merger for the following reasons:
- (a) The passengers using these closed routes would have had to use other similar bus services or other transport methods. Given the high degree of overlap between the East Coast Bus Business services and the Acquirer's pre-Merger services, the majority of passengers would have been likely to use the Acquirer's services, where these services overlapped pre-Merger.
  - (b) Other bus operators in the area had a significantly more limited presence than the Acquirer pre-Merger. Although two operators have expanded their service offering to a small extent since the Merger, their submissions strongly indicate that they would have only considered relatively modest further expansions, and in one case even this would have been challenging without further investments in capacity, which as outlined above, even in the absence of the Merger would not have been available to them.
  - (c) Evidence from bus operators indicated that entry or expansion in the area would have required further investments in capacity in the form of depots. Evidence from a bus operator indicated that it was very difficult to obtain Depot capacity in the East of Edinburgh and East Lothian areas. As such, the CMA does not therefore consider entry or expansion by another bus operator to be credible.
  - (d) The Acquirer was better placed to register many if not all of the routes previously operated by the East Coast Bus Business where the Parties had overlapped pre-Merger. In this context, the Acquirer submitted that it had actively considered re-registering the routes corresponding to those run by the East Coast Bus Business on being aware that the

Undertakings were being reviewed and may be lifted in March 2015 and on the assumption that the Seller may seek to close some routes once these Undertakings were lifted. The Acquirer submitted detailed analysis produced independently of the Merger discussions, which assessed the operational effect of running the East Coast Business routes from its own existing depots in Marine and Seafield. This analysis indicates that the large majority of routes could have been run without significant impact on operational (bus driver) hours and mileage though some would require timetable adjustment to allow for the less convenient location of the Acquirer's depots. As such, while this approach may not have provided as commercially attractive a solution as acquiring the additional capacity the Acquirer did via the Merger, the Acquirer's internal planning indicates that absent the Merger it would have been better placed than other operators to capture the majority of the routes previously operated by the East Coast Bus Business.

70. In further support of the evidence above two groups who represent customers who responded to the CMA enquiries, expressed the view that the Merger would not have made any difference in terms of the counterfactual and that LB would have registered substantively similar routes whether or not it had purchased the Acquired Assets.

### *Conclusion on limb 3*

71. Based on evidence it has gathered from the Parties and from other bus operators the CMA believes that in the absence of the Merger, the Acquirer would have registered the majority of bus routes it has registered following the Merger regardless of the Merger and would have been able to operate these using its existing depot capacity. Additionally, and in any event, it does not appear that other bus operators were planning on further expansion into this area had the Merger not taken place. Therefore, the CMA believes that an overwhelming majority of FirstGroup's sales would have switched to LB under the counterfactual where the East Coast Bus Business exited the market.<sup>36</sup> As a result of this the CMA considers that the Merger meets the criteria of limb 3 of the exiting firm test.

### ***Conclusion on the relevant counterfactual***

72. For the reasons set out above, the CMA believes that all three limbs of the exiting firm counterfactual are satisfied in this case. The CMA believes that

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<sup>36</sup> The CMA considers this to be the case for both commercial and tendered services. It is clear to the CMA that it would have made no difference to the degree of competition for tenders in the area whether the Acquired Assets were owned by LB or had exited the market entirely.

there is no realistic prospect that the East Coast Bus Business would have continued in operation absent the Merger as there is compelling evidence that it would inevitably have exited the market. The CMA also believes that there was no realistic alternative purchaser of the East Coast Bus Business at or above liquidation value other than LB. Lastly, the CMA believes that, if the East Coast Bus Business were to exit the market, the majority (if not all) of its UK sales would divert to LB in any case.

73. Relative to this counterfactual, the CMA believes that the Merger will not give rise to a realistic prospect of an SLC because, absent the Merger, the same loss of competition in the market would arise.
74. Having reached this conclusion on the relevant counterfactual it was unnecessary for the CMA to carry out a competitive assessment in this case.

### **Third party views**

75. The CMA contacted customer groups and competitors of the Parties. Competitor responses have been discussed above. No customer groups contacted raised any concerns about the Merger and indeed welcomed it, indicating that they believed that as a result of the Merger services had improved significantly. No third parties raised concerns about the Merger.
76. Third party comments have been taken into account where appropriate in the competitive assessment above.

### **Decision**

77. Consequently, the CMA does not believe that it is or may be the case that the Merger has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom.
78. The Merger will therefore **not be referred** under section 22(1) of the Act.