

# 8 Conclusions

## The merger situation

8.1. Under the terms of the reference and the relevant sections of the Fair Trading Act 1973 (the Act), we are required to investigate and report whether a merger situation qualifying for investigation, in which the condition set out in section 64(1)(b) is satisfied, has been created. Since this reference is made under section 69 and not under section 75, the subject of our inquiry is the merger situation (if any) which has already been created, not any merger situation which might result from arrangements now in progress or contemplation. Some of those who submitted evidence to us did not draw this distinction. We considered whether we could give some indication of what our view might be of a full merger of the two companies, but in the event we decided not to do so (see Appendix 8.1).

8.2. In January 1986 P & O acquired a controlling interest in European Financial Holdings Ltd which held 20.8 per cent of the shares and 16.1 per cent of the voting rights of European Ferries. Simultaneously with this acquisition the Chairman of P & O obtained a non-executive seat on the European Ferries main Board and one of P & O's senior executives a seat on the Board of EF International, a subsidiary engaged in property activities in the United States.

8.3. In consequence of sections 64 and 65 of the Act the first question we have to consider is whether this acquisition enables P & O materially to influence the policy of European Ferries so that for the purposes of section 65 of the Act enterprises carried on by the two companies have ceased to be distinct from each other (see paragraph 5.2).

8.4. There have been only a few cases in which the Commission have had to consider ability materially to influence the policy of a company rather than to control it. In all the cases in which the Commission have found ability materially to influence policy the voting rights have been in excess of 20 per cent.<sup>1</sup> We have considered whether there are circumstances peculiar to this case which would lead us to conclude that, despite the relatively small proportion of voting rights, P & O is able materially to influence the policy of European Ferries.

8.5. P & O from the outset of this inquiry maintained that it had this ability. At first European Ferries disputed this but, following a Board meeting on 10 September, it informed us that it had changed its view and now accepted that P & O had material influence over its policy. The fact that both companies now agree on material influence we regard as significant but not decisive.

8.6. EFH's shareholding is large by comparison with other holdings in European Ferries. European Ferries' representatives have confirmed to us that no shareholder other than EFH controls 5 per cent or more of the voting rights. The published accounts show that European Ferries has a large number of small shareholders. P & O believes (paragraph 7.6) that it has good connections with most of the institutional shareholders, and that it could probably block any resolution of which it disapproves. It also believes that any proposal sponsored by

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<sup>1</sup> The cases are:	%
Eurocanadian Shipholdings/Furness Withy/Manchester Liners (1976 HC 639)	28.80
GUS/Empire Stores (1983 Cmnd 8777)	29.99
Pleasurama/Trident/Grand Metropolitan (1983 Cmnd 9108)	20.02
Lonrho/House of Fraser (1985 Cmnd 9458)	29.90

P & O would be likely to be passed. As for influence on the Board, P & O believes that if it could satisfy the non-executive directors of the rightness of any proposal, that proposal would be accepted by the Board.

8.7. P & O's auditors, Peat, Marwick, pointed out to us that according to the appropriate accounting standard (SSAP 1), voting rights of 20 per cent were regarded as the minimum through which a company could be deemed to have significant influence, unless there were exceptional circumstances. They regarded considerations such as those set out in paragraphs 8.2 and 8.6 as important in determining whether or not equity accounting by P & O for its shareholding in European Ferries should be allowed. Peat, Marwick explained that P & O's effective votes were greater than 16.1 per cent because the preference shareholders tended not to exercise their voting rights on matters other than those affecting European Ferries' concessionary fares and that therefore their voting rights could be discounted. However, what in Peat, Marwick's view was decisive was the representation on the European Ferries Board by the Chairman (and by the Managing Director as his alternate) of a company the size of P & O. These special factors taken together led Peat, Marwick to conclude that P & O had significant influence over European Ferries even though its shareholding was less than the accounting standards would normally require.

8.8. In order to demonstrate P & O's ability materially to influence European Ferries' policy, P & O and European Ferries each gave us examples of action by P & O's representatives or intervention in the affairs of European Ferries. In Chapter 7 we refer to two main instances: the decision to include in European Ferries' accounts for 1985 a provision of £15 million for the fall in the value of the group's properties in the United States and European Ferries' eventual acceptance, in a formal resolution reversing the attitude it had previously adopted before us, that P & O did have the ability to influence its policy. We were also told that because of the attitude of P & O's representatives, European Ferries did not proceed with certain plans and appointments suggested by its management.

8.9. On the first of these instances European Ferries took the view (paragraphs 7.16 to 7.20) that the decision to include a provision in its accounts came about during the course of exchanges of view amongst directors at a Board meeting; that there was nothing unusual or significant about the way the decision was taken; and that it did not demonstrate an ability by P & O to exercise material influence. The evidence of P & O and its auditors was that the discussion of this item at the Board meeting was the culmination of earlier discussion and negotiation in which P & O had played a significant role. In particular the initiative for convening a meeting of representatives of the two companies and their auditors on 6 May 1986 (the day before the Board meeting) came from P & O and not European Ferries. The Finance Director of European Ferries has accepted (paragraph 7.19) that the draft note to the accounts (paragraph 6.18), which did not include any provision, represented his view before the meeting of 6 May.

8.10. We therefore think that the European Ferries Board would have published the accounts without this provision being made had it not been for the intervention of P & O, and that this constituted more than the kind of intervention one might expect from a forceful non-executive director taking a broader view of where the company's best interests lie. In fact this was not simply a case of a director taking a particular line; P & O took a great deal of trouble over this matter, arranging meetings and consulting its auditors.

8.11. We refer in Chapter 7 to the European Ferries' Board meeting of 10 September at which was recorded in the minutes the Board's agreement that P & O had the ability materially to influence the group's policies. Although the accounts we have been given of what happened before and during that meeting differ in detail and emphasis, we think that P & O took the initiative in raising the issue and was instrumental in canvassing support for it among the non-executive directors (and Messrs Dick & Pauls) and obtaining a majority in favour of the decision at the Board meeting. It is also clear from these accounts that the matter would not have been raised and carried had P & O not taken this initiative. The Chairman, the (then) Managing Director and the executive directors of European

Ferries (apart from Messrs Dick & Pauls) had been content with the earlier view expressed to us that there was no material influence. Also as a result of the attitude of P & O's representatives at the time of the Board meeting certain plans and appointments advocated by the European Ferries' management were not pursued.

8.12. In our view the factors described in paragraphs 8.2 and 8.5 to 8.7 give P & O the potential to influence the policy of European Ferries. The examples described in paragraphs 8.8 to 8.11 show the exercise of that material influence.

8.13. The assets of European Ferries exceed £30 million. The condition stipulated in section 64(1)(b) of the Fair Trading Act is thus satisfied.

8.14. We conclude that P & O has the ability materially to influence the policy of European Ferries; that in the terms of section 65 of the Fair Trading Act enterprises carried on by the two companies have ceased to be distinct from each other; and that therefore a merger situation qualifying for investigation has been created.

**Limitations of material influence**

8.15. In this inquiry we are not considering a full merger. Although, as we have said, in the terms of the Fair Trading Act the two enterprises have ceased to be distinct from each other, in practice P & O and European Ferries operate as two separate companies with two Boards each taking its own decisions and accounting for them independently.

8.16. An ability to exercise material influence over a company's policy is not the same as an ability to control it. One way in which this influence could be exercised might be in the form of persuading a company to take a course of action that it might not otherwise have considered taking or even of persuading it to take a course of action it would have preferred not to take. If, however, a director considers that a course of action advocated by the influencing company would involve serious detriment to the interests of the company he may be able to muster enough support amongst the Board to oppose it. It would not be right therefore to assume that P & O would be able to force on European Ferries measures which the latter felt would harm its vital interests. There are limits to P & O's material influence.

**The public interest**

8.17. We consider that no public interest issues arise from European Ferries' property activities in the United Kingdom or abroad. The main areas affecting the public interest where the activities of P & O overlap with those of European Ferries are in the provision of ferry services across the North Sea and to and from Northern Ireland, and in the provision of port facilities. We have focused our inquiry on these areas.

8.18. Since it sold Normandy Ferries to European Ferries in 1985, P & O has operated no services to or from France. On the Continental routes the services of the two companies which overlap are those to and from Belgium and Holland. However, as we point out in Chapter 2, for many passengers and freight hauliers French, Belgian and Dutch ports are only staging posts on the route to further destinations such as Germany and Italy. To a considerable extent and despite the French licensing constraints (paragraph 2.18), these customers regard the short sea routes to and from France and the routes to and from Belgium and Holland as close substitutes for each other. We have therefore looked at routes to Belgium, Holland and France as a whole.

8.19. The position of ferry services across the Irish Sea is different. We have noted in paragraph 2.12 that approximately 20 per cent of freight traffic between Great Britain and Northern Ireland ports is destined for or originates from the Republic. It is more direct to ship a consignment of goods between central Scotland and the Republic of Ireland through Larne or Belfast than to ship it via Holyhead and Dublin. An added advantage, we were told, is that customs clearance at the border between Northern Ireland and the Republic is more rapid than that at the ports in the Republic, particularly Dublin. On the other hand there

is practically no freight conveyed between Great Britain and Northern Ireland via the Republic because such a journey would involve customs clearance on two occasions, whereas shipment between Great Britain and Northern Ireland involves none at all. For this reason we do not regard the freight services to and from the Republic as being an adequate substitute for those between Great Britain and Northern Ireland. Since European Ferries does not operate a service to and from the Republic we have focused this part of our inquiry exclusively on the routes to and from Northern Ireland.

8.20. We have also concentrated on freight rather than on passenger services. On the Continental services referred to in paragraph 8.18, P & O's share of the passenger market is only 3 per cent compared with European Ferries' 51 per cent. European Ferries' market share is already large, and P & O's small additional increment is not likely in our view significantly to increase European Ferries' market power. P & O now operates no passenger service to Northern Ireland. In the provision of freight services, however, the relative size of P & O's and European Ferries' market shares has potentially greater significance for competition (see Tables 2.1 and 2.2).

**Competition** 8.21. We now consider whether P & O and European Ferries, as a result of the present merger situation, are able to restrict or distort competition in the provision of freight ferry services on the short routes across the Channel and the North Sea and on the routes to and from Northern Ireland.

8.22. We have shown (Table 2.2) that European Ferries has a 42 per cent share of the Continental freight ferry services and P & O 10 per cent. P & O's most significant share is of the Dutch sector where it accounts for 23 per cent compared with European Ferries' 21 per cent of the market. On the Northern Ireland services (Table 2.1), P & O's share of the total freight market is 26 per cent and that of European Ferries 24 per cent.

8.23. The two companies could try to restrict or distort competition in the following ways:

- (a) by raising the price of services to the customer;
- (b) by reducing prices in order to drive competitors out of the market; or
- (c) by rationalising or integrating services in various ways to the detriment of customers or competitors.

The viability of such measures would depend principally on the number of other competitors in the market, any barriers to entry to the market and its attractiveness to new entrants.

**Raising prices** 8.24. We have explained in paragraph 2.4 that prices for transport of freight on both sets of routes tend to be set by a bargaining process between the ferry operators and their individual customers (the road hauliers). Both companies gave us evidence of heavy discounting.

8.25. On the routes to and from the Continent, in addition to the main parties, some ferry operators which submitted evidence to us stated that attempts by them to co-ordinate increases in price through freight harmonisation conferences have proved unsuccessful. It is not difficult to see why. Apart from the three large operators, P & O, European Ferries/RMT and Sealink, there are at least 12 operators on these routes which between them account for 32 per cent of the freight market. The road haulier thus has a wide choice of services which secures his bargaining power with even the largest operators.

8.26. Over the years there have been changes in the market as long-established operators have left to be replaced by new entrants and the process appears to be continuing (see paragraph 2.20). Not only does there appear to be substantial spare capacity on the freight ferry services themselves but there is also surplus capacity in the shipping market making chartering a simple and relatively inexpensive operation, and there is plenty of berth space available in the increasing

number of operational ports in South-East England. All this suggests to us that there are few barriers to entry in the market we are considering, that the market continues to attract new entrants, that the customer has a wide choice of service and substantial bargaining power and that the scope therefore for P & O and European Ferries to raise their prices is severely limited.

8.27. On the routes to and from Northern Ireland the market is smaller and appears to be static or even in decline. There are fewer operators, and P & O, European Ferries and Sealink between them have over 80 per cent of the business. There has been a history of collusion (paragraph 2.5) amongst operators on these routes although P & O and European Ferries claim that all such agreements have lapsed since 1984. As on the Continental routes there are no barriers to entry, but the market is at present less attractive to a new entrant. When we put it to P & O and European Ferries that they might be tempted to raise prices they replied that Sealink was a sufficiently strong competitor to make such course of action unwise. This argument presupposes that Sealink would continue to compete rather than follow P & O/European Ferries' lead with a comparable price rise.

8.28. We recognise that the two companies might have more scope for raising prices on the Northern Ireland routes than on the routes to and from the Continent. However, by raising prices in this way the main operators would improve the attractiveness of the market both to existing small competitors who might find it worthwhile to expand their capacity and to new entrants. Even in the present conditions Belfast Freight Ferries has doubled its capacity by putting a second vessel on its service between Heysham and Belfast. We believe such factors to be a constraint which in present circumstances would deter the companies from raising prices significantly.

8.29. It was also put to us that P & O and European Ferries might consider raising the cost of berth facilities at Larne for operators other than themselves, particularly Sealink. Larne is a small port serving few operators, of which Sealink is the largest. European Ferries has so far made no attempt to give its own vessels preferential rates there. The facilities at the port are adequate for all the present requirements of Sealink, P & O and European Ferries. If European Ferries were to discriminate against Sealink, Sealink might at some point transfer its ferries elsewhere, eg to Belfast, thus depriving European Ferries of valuable harbour revenue. European Ferries has always maintained Larne as an open port, and we think that it would be likely to resist any pressure from P & O to change this policy.

**Reducing prices**

8.30. On the routes to and from the Continent a policy of predatory pricing would appear to be unlikely to succeed. Although, as has been stated in paragraph 8.25, many of P & O/European Ferries' competitors have small market shares, many of them are either large concerns in their own countries (Netherlands, Denmark and Germany) or state-owned or guaranteed and thus well placed to withstand a price war. On the Northern Ireland routes the objective of such a policy would be to eliminate competitors from the market thus creating for P & O/European Ferries a virtual monopoly, but other companies could re-enter the market once P & O/European Ferries put up their prices again.

**Rationalisation or integration of services**

8.31. With the present state of over-capacity in the supply of ferry services, we should not regard some measure of rationalisation as surprising. For example, during the course of our inquiry we learned of the request by European Ferries and Sealink to be released from their undertakings to the Office of Fair Trading that they would not engage in price discussions in order that they could discuss possible rationalisation of their services to meet the anticipated competition in the 1990s from the Channel Tunnel. We understand that the Secretary of State has turned this request down. We have to consider whether possible rationalisation of P & O's and European Ferries' services would be attributable to or facilitated by the present merger situation.

8.32. Some organisations which submitted evidence to us (see Chapter 6) have expressed concern about three possible ways in which the two companies might rationalise or integrate their services to the detriment of third parties:

- (a) discontinuing a service by one company and transferring the freight to a service operated by the other company;
- (b) transferring a ferry service from a port owned by another organisation to a port owned by European Ferries; and
- (c) integrating P & O's haulage operations with European Ferries' ships.

8.33. The principal example suggested to us of the first of these possibilities was the closure of P & O's service from Ardrrossan and the despatch of NITS trailers on European Ferries' vessels from Cairnryan. We believe that the future of P & O's Ardrrossan service will be influenced much more by its own performance and results than by the existing association between P & O and European Ferries.

8.34. The main example suggested to us of the second of these possibilities was transferring P & O's North Sea Ferries' service from Ipswich to Felixstowe. P & O could do this irrespective of the merger situation if it considered the move commercially attractive. However, European Ferries argued that there would be no advantage to it in P & O's services displacing its own and no advantage to European Ferries' harbour subsidiaries in offering P & O berths at anything less than the commercial rate. We believe it is likely to resist pressure from P & O to do so.

8.35. The example suggested to us of the third possibility was that P & O's Ferrymasters and Pandoro subsidiaries might make preferential use of European Ferries' vessels. However, European Ferries made it clear to us that it would stand to lose valuable business from haulage operators other than Ferrymasters and Pandoro, if it were to offer these two companies preferential treatment. If it were to charge them less than the commercial rate the outcome would be a substantial loss to European Ferries.

8.36. Ipswich Port Authority and Sealink drew our attention to the possibilities set out in paragraph 8.32(b) and (c) respectively. They both related their concerns specifically to a full merger between P & O and European Ferries, not to the present merger situation. We do not think the present merger situation is likely to lead to either of these consequences, which offer no advantage to European Ferries and might involve it in substantial financial loss. P & O has acknowledged (paragraph 7.45) that integration of services would not be to the advantage of European Ferries. These are therefore issues upon which P & O's influence would not be likely to prevail (paragraph 8.16).

## Conclusion

8.37. We have concluded (paragraph 8.14) that a merger situation has been created by the ability of P & O to exercise material influence over the policy of European Ferries. As to the public interest, we have shown that in this situation the scope for the two companies to combine in order to restrict or distort competition is limited. On the matters of rationalisation and integration, we consider that some developments (see paragraphs 8.33 to 8.36) could take place irrespective of the present merger situation while others would be unlikely given that they would result in detriment to one of the parties concerned and would thus be resisted by that party. We have not found evidence therefore that the present merger situation has of itself brought about changes detrimental to the public interest or that it may be expected to do so.

8.38. We therefore conclude that the present merger situation resulting from P & O's ability materially to influence the policy of European Ferries does not operate against the public interest and may be expected not to do so.

J G LE QUESNE (*Chairman*)

M B BUNTING

A FERRY

A M HEAD

M S LIPWORTH

S C LITTLECHILD

S N BURBRIDGE (*Secretary*)

31 October 1986