

7 Conclusions

The merger situation

7.1. Under the reference, dated 17 October 1988, we are required to investigate and report whether a merger situation qualifying for investigation, as defined in section 64(8) of the Fair Trading Act 1973 (the Act), has been created, in that enterprises carried on by or under the control of Midland Red West Holdings Ltd (MRWH) have within the six months preceding the reference ceased to be distinct from enterprises carried on by or under the control of Badgerline Holdings Ltd (BHL). In order to proceed with the investigation we must first be satisfied that the condition specified in section 64(3) of the Act is fulfilled in respect to the supply of bus services. In the reference the area for this supply (the specified area) is defined as the County of Avon, together with all parts of the Counties of Somerset and Wiltshire, and of the County of Gloucester east of the River Severn, which lie within 15 miles of the County of Avon.

7.2. The date of the acquisition of MRWH by BHL was 22 April 1988, less than six months before the date of the reference. We therefore conclude that enterprises carried on by or under the control of BHL and MRWH have ceased to be distinct from each other within the terms of section 64(4)(a) of the Act.

7.3. Section 64(3) of the Act requires us to be satisfied that BHL supplies at least one-quarter of the bus services in the specified area. On 1 May 1988 BHL supplied some 40 per cent and MRWH some 42 per cent of bus services as measured by bus miles in the specified area. On this basis the combined enterprises' share of the supply of bus services in the specified area was around 82 per cent (see paragraph 3.11). The position has not materially changed. The market share test having been satisfied, the reference requires us to exclude the alternative assets test prescribed by section 64(1)(b) of the Act.

7.4. We have set out in Chapter 2 our detailed reasons for concluding that the specified area is a substantial part of the United Kingdom as required by section 64(3). One member dissented from this conclusion.

7.5. We conclude that the condition specified in section 64(3) is satisfied in respect of the supply of bus services in the specified area and that a merger situation qualifying for investigation has therefore been created.

Background

7.6. The Transport Act 1985 (the Transport Act) has had a major effect on the operation of bus services in Great Britain. Three provisions are of particular importance in the specified area:

- (a) the abolition of road services licensing for local services outside London;
- (b) the restriction of subsidy to local services required to meet social need and not provided commercially, the subsidy for such services to be awarded by competitive tender; and
- (c) the break-up and privatization of the National Bus Company (NBC).

The intention as stated in the White Paper *Buses* (the White Paper) was to remove by deregulation obstacles to enterprise, initiative and efficiency and encourage competition in the provision of bus services as competition provided the opportunity for lower fares, new services and more passengers. By permitting local authorities to continue to subsidize bus services that were considered to be socially necessary the Act established two systems, one for commercial services and one for local authority tendered contracts.

7.7. An important element in introducing competition and choice was the Government's decision to split NBC into 72 companies for the purpose of privatization. The Department of Transport told us that the Government had aimed to form independent units which were viable but had boundaries such as to encourage competition. A single purchaser was allowed to acquire up to three of NBC's subsidiaries provided the areas in which they operated were not adjacent. Under this arrangement a bid by Badgerline for City Line would not have been allowed at that time (see paragraph 6.7).

7.8. As part of this pattern of privatization the bus operations of the Bristol Omnibus Company (BOC) subsidiary of NBC were split into two parts: one, trading as City Line, serving the centre and suburbs of Bristol, and the other, trading as Badgerline, serving the area surrounding Bristol and linking it to the centre of the city. In September 1986 BHL purchased Badgerline from NBC. A year later MRWH purchased City Line from BOC and in April 1988 BHL took over MRWH.

7.9. It may be thought that BHL's taking over MRWH has frustrated the Government's clear intention when privatizing NBC that City Line and Badgerline should provide competing services in Bristol and the surrounding area. In our consideration of the public interest issues arising from the merger, we bear in mind that, for the purposes of privatization, BOC was split up in order to foster competition (see paragraph 6.7). We also note, however, that the Government said at paragraph 5.15 of the White Paper that the market could set the pattern of operation and ownership of the NBC companies; and the Transport Act itself makes no reference to the future structure of the industry nor to restrictions on the acquisition of the companies.

Commercial bus services

7.10. Deregulation ended the system of licensing bus services which had been in place since the 1930s. It is now necessary for an operator only to register a service and there is no regulation of the quantity of services provided. Operators are free to compete with each other on this basis. Nevertheless we found that in the provision of commercial services in the specified area Badgerline and City Line had not competed with each other following deregulation and that they faced only limited competition from other operators. We do not consider that this situation has changed since the merger.

7.11. It is widely accepted that the former NBC companies with their experienced management teams had an advantage in the first stages of deregulation as a result of their knowledge of the local markets and their established fleets. They had also been helped by NBC's substantial investment in minibuses prior to deregulation. Potential new entrants could only hope to fill any gaps or niches left in the market and these niches commonly turned out to be few. Established operators were stimulated to improve their services in the new environment; failure to act in this way would have left market opportunities open to new operators, even though incumbents would retain some advantages from their established position. Head-to-head competition appears not to have been financially attractive. Badgerline told us that its own experience in Salisbury where it entered the market in competition with the incumbent Wilts and Dorset Bus Company but had to withdraw in the face of substantial losses had reinforced this view (see paragraph 5.8).

7.12. The picture that has emerged in the specified area conforms to this pattern. In October 1986 only City Line registered any commercial services to operate within the city of Bristol. Since then six commercial services have been registered by other operators but they do not run on routes served by City Line. In November 1988 City Line operated 43 commercial services in Bristol. At that time Badgerline ran 134 commercial services in the specified area, including Weston-super-Mare, Bath and Chippenham. It argued that it faced competitive services over the whole or part of 52 of these services, from 21 other operators. Analysis of the affected services showed that the extent of competition varied considerably and in some cases it was limited either to part of a route or to a small proportion of services in the day (see paragraphs 3.17 and 3.18).

Local authority tendered contracts

7.13. Since deregulation some 80 per cent (by value) of the contracts in the specified area have been let by the County of Avon (Avon); the balance has been let by the Counties of Gloucestershire, Somerset and Wiltshire. In the rest of the specified area outside Avon, Badgerline has been active in tendering but City Line has not. In October 1986 Avon put 182 services and variants of services out to tender (see paragraphs 3.28, 3.29 and Table 3.2). Tenders were submitted by 28 operators. There were 77 contracts for which Badgerline and City Line both submitted bids. For 45 of these contracts they were the only tenderers and there was a marked difference in the two companies' bids in a number of these cases. There were 27 cases for which four or more tenders were received. There were on average 2.5 bidders per contract. In the spring of 1988, following a review of a number of services, tenders were invited for 66 services (see paragraph 3.32 and Table 3.3). There were on average four bids per contract. Badgerline and City Line both tendered for 33 contracts and in 12 cases they were the only bidders. There were 34 services for which four or more tenders were received.

7.14. An analysis of all 298 contracts covering the two tender rounds referred to above and, a number of other contracts awarded by Avon since deregulation, shows that Badgerline and City Line were the only bidders for 22 per cent of the contracts accounting for 34 per cent of total contract value. In a further 12 per cent of contracts (accounting for 8 per cent by value) there was only one bidder in addition to Badgerline and City Line and in a further 25 per cent (accounting for 28 per cent by value) Badgerline or City Line bid alone or with only one other company (see paragraph 3.34 and Table 3.5). In the year ended 31 October 1988 Avon spent £3.7 million on contract services. Of this City Line received £1.6 million and Badgerline £1.3 million, a combined share of just under 80 per cent (see Table 3.6).

7.15. We have also considered the most recent round of tenders received by Avon in December 1988 (see paragraph 3.33 and Table 3.4). Tenders were sought for 125 services and there were on average 3.8 bids per service. In only 16 cases were Badgerline and City Line together or separately the only bidders. There were 65 services for which four or more tenders were received and a further ten services on which there were two other bidders in addition to either Badgerline or City Line. At the time of completing our inquiry contracts had not been awarded for these services but we believe that BHL will continue to be as important a supplier of Avon's contract services as in the past.

7.16. In order for passengers to benefit from interavailability of tickets Avon has introduced a requirement that operators of subsidized services should accept tickets issued by other operators. A consequence of this has been to give a benefit to BHL as the principal issuer of tickets in the area, in the form of ticket revenue for journeys not necessarily made on a bus operated by BHL. This revenue is also perceived by some operators as giving BHL an additional competitive advantage in bidding for contracts but we were not persuaded that this latter perception was correct.

Competition issues

Market dominance

7.17. It is clear from paragraphs 7.12 and 7.15 that BHL is the dominant supplier of both commercial and contract bus services in the specified area. Overall, as we have seen, it runs over 80 per cent of the bus miles provided in that area. It receives a similar proportion of the subsidy provided by Avon for local bus services.

7.18. As regards commercial services, Badgerline and City Line were dominant in their own areas of operation before the merger. Nevertheless, several bus companies told us that the merger had increased the dominance of the two enterprises within the specified area to the extent that it was now overwhelming.

BHL, including Midland Red West and Western National, now had at its disposal some 1,500 buses and the resources that went with them; it was not feasible to take them on (see paragraph 6.40).

7.19. BHL saw matters differently. It considered that competition for bus passengers was a local affair. Passengers would desert BHL for other companies or other modes of transport if it did not provide the required level of service and value for money. Moreover it was always open to a smaller company to identify a niche in the market which it could fill profitably by providing an attractive service. In BHL's view barriers to entry were low. It was always possible to hire vehicles or buy second-hand. Engineering facilities were readily available and access to bus stations could be obtained where required (see paragraph 5.12). We accept that costs of entry are low but note that despite this, no competitors have so far emerged for City Line's commercial services and we have seen no indication that they are likely to do so.

7.20. As we have indicated, City Line provides nearly all the commercial services in Bristol and the competition faced by Badgerline on commercial services in its own area of operation is of a limited nature (see paragraph 7.12). However, we have seen no evidence that this situation was changed by the merger.

7.21. As we have shown in paragraphs 7.13 and 7.14, either Badgerline or City Line and often both bid for nearly all Avon's tendered contracts, which account for the bulk of contracts let in the specified area, and they have been awarded a high proportion of them. We have considered whether:

- (a) the actual competition between Badgerline and City Line for Avon's contracts; and
- (b) the potential for an extension of competition between them to those contracts where up to the present only one of them has made a bid;

could be expected to be removed if the merger were allowed.

7.22. Avon said that the fundamental issue arising from the merger was whether Badgerline and City Line would continue to compete for its contracts. It was concerned that if they did not continue to compete with each other the effect would be to drive up tender prices in the future and that this would eventually affect passengers because the County did not have unlimited resources available to meet transport needs. If a way could be found to eliminate the impact of the merger on tender prices it would be content. However, Avon saw it as extraordinarily difficult to create conditions which would prevent collusion on tendering between the merged companies (see paragraph 6.30).

7.23. BHL told us that the two companies still worked independently in producing their own budgets and commercial plans and submitting tenders for a contract service on a cost plus standard mark-up basis reflecting each company's own resources. It also said that as they would continue to operate in this way there would be no loss of competition in tendering for contract services. More generally, BHL argued that the steady increase in the number of tenders submitted since deregulation was evidence of growing competition in this area of its operations (see paragraph 5.12).

7.24. We accept that BHL does face competition from other operators for the provision of contract services. However, we share Avon's view that the merger may be expected to place in jeopardy the continuation of competition between Badgerline and City Line and thereby reduce competition for its contracts. Badgerline and City Line have been the only two bidders for a significant number of these contracts; for many contracts there has been only one other bidder. The merger may also be expected to reduce the potential for an extension of competition between Badgerline and City Line to those contracts where up to the present only one of them has made a bid. In many of these cases also there has been competition from only one other bidder although in recent tender rounds there has been a substantial increase in the average number of bids per contract and the proportion of contracts for which there are four or more bids (see paragraphs 7.13 to 7.15).

7.25. The fact that a growing number of comparatively small operators is competing for the above services does not allay our concern. It is much easier for one of the BHL companies with its economies of scale to win a contract against a small operator than against the other BHL company, in a situation where they were both tendering independently on an arm's length basis. The increased number of bids from small operators is very welcome but the crucial requirement to keep tender prices down is that Badgerline and City Line should genuinely bid against each other rather than there should be one, two or more small operators also bidding. We have already expressed our belief that BHL will continue to be as important a supplier of Avon's contract services as in the past (see paragraph 7.15).

Allegations of anti-competitive practices

7.26. We received a number of complaints alleging anti-competitive practices by BHL as set out in Chapter 6. They included six tenders in which Badgerline withdrew a commercial service, tendered unsuccessfully for the local authority replacement service, and then reintroduced a commercial service. BHL conceded that it was unhappy about the way four of these services had been introduced without giving advance notice to Avon, although the reintroduction had been for good operating reasons (see paragraph 6.48).

7.27. The effect of this kind of behaviour may well be to force the withdrawal of the new contract service, which could be financially embarrassing to a small operator who had invested in additional equipment in order to take on the contract service. If this happened at all frequently a further effect could be to discourage that operator and other operators from subsequently tendering for contract services which are replacing services deregistered by Badgerline or City Line, thereby leaving the way open for Badgerline or City Line to have a good chance of winning the contracts at comparatively high prices. BHL argued that replacing a subsidized service by a commercial one saved County funds (see paragraph 6.48). The County told us, however, that the competing commercial services had not always replaced the subsidized services in full. It had then been faced with increasing the subsidy to replace revenue lost by the contract operator or accepting a reduced contract service for the same contract price (see paragraph 6.29).

7.28. We also received a complaint about Badgerline's decision to provide the extra journeys free when it was unable to register a full frequency service in competition with Norman Coaches during the standstill period from 26 October 1986 to 25 January 1987. Badgerline's explanation was that this was done to meet its passengers' requirements (see paragraph 6.50).

7.29. BHL's refusal to accept other operators' tickets was also the subject of complaint. BHL argued that it would be uneconomic to do so. It agreed that there were several cases in which operators running a tendered service along a route served by a BHL commercial service were required to accept BHL tickets, though the reverse was not required but pointed out that this was a condition imposed by Avon when awarding the contract (see paragraph 6.52).

7.30. There is often a fine line between vigorous competition and the aggressive use of market strength to the point where it becomes anti-competitive. A supplier of BHL's degree of dominance has to be particularly careful not to cross that line. On the one hand we do not criticize BHL's refusal to accept other operators' tickets; it would not be easy to arrive at economic revenue pooling arrangements involving a substantial number of operators. And Badgerline's offering a free service to get round the standstill period at the commencement of deregulation, whatever may be the correct explanation, is relevant only as an indication of BHL's likely reaction to market situations which affect its commercial interests.

7.31. On the other hand, Badgerline's reregistration of commercial services having failed to win the tendered contracts is an anti-competitive practice which we should expect to increase as a result of the merger with the effect of discouraging small operators from tendering.

Benefits rising from the merger

7.32. BHL told us that while MRWH had a higher profitability than BHL, MRWH had a smaller asset base; that gave a good mix. Furthermore the merger was enabling BHL to increase efficiency significantly in terms of services offering better value for money by more effective management of the joint bus fleet. Another important benefit was the projected merging on to a single site of Badgerline's Bristol engineering workshop and City Line's workshop, thus releasing a major city centre site for development; this move would reduce engineering costs and provide new capital to finance the growth of the business. BHL was not able at this stage to quantify the value of these potential benefits. However, it had identified savings of £280,000 a year on overheads and £310,000 a year on procurement (see paragraph 5.13). We accept that benefits of rationalization and the associated cost savings will be substantial. BHL also said that the effect of these benefits would be to lower the cost base for its tenders for contract services (see paragraph 6.43).

7.33. It is also clear that the restoration of interavailability of tickets between Badgerline and City Line has been popular with passengers, although we believe this could have happened without the merger if it was perceived that it was likely to give mutual commercial advantage to the two operators.

Summary of public interest issues

7.34. We believe that the effect of the Transport Act on local bus services in the specified area has broadly been to facilitate the matching of supply and demand with a flexible response to the needs of the travelling public and the provision of such services at acceptable fares. The result has been a marked upsurge in bus travel and significant progress in reducing City Line and Badgerline unit costs (see paragraph 4.11). Most of these effects took place before the merger. Moreover there has been virtually no complaint to the Commission about the quality of service provided.

7.35. Nevertheless, we are concerned that existing competition and the potential for extending that competition should be preserved after the merger. There are over 100 bus companies in the specified area but we have seen no evidence that any of them are in a position to provide substantial competition to BHL in its core business of providing commercial stage carriage services. Prior to the merger Badgerline and City Line were of comparable size, dominant in their own areas of operation but capable of competing with each other. There was thus the potential for such competition which might have served to keep the companies on their toes. We note that they chose not to compete, believing that their services were complementary and that experience elsewhere showed that head-to-head competition between the companies would be futile.

7.36. BHL argued that the main incentive for a bus company to reduce unit costs, respond to the needs of passengers and provide value for money was competition from other modes of transport. The history of the industry, that if satisfactory levels of service were not delivered at the right price patronage dropped and there would be an opening in the market which other bus operators, possibly from outside the area, would find it attractive to fill. It was therefore in BHL's interests to maintain standards and avoid loss of patronage (see paragraph 5.11). We find this a persuasive argument. Taking into account also that Badgerline and City Line did not compete in the provision of commercial services prior to the merger, we concluded that there was no material loss of potential competition in providing them.

7.37. Even if City Line were sold to a third party, the view held by current management that its commercial services are essentially complementary to Badgerline's would be likely to prevail with the result that it would not compete with Badgerline. There is no reasonable expectation that divestment of City Line to a third party would increase competition in the provision of these services.

7.38. The position is clearly different, however, in the provision of contract services. Here there was competition between Badgerline and City Line before the merger and there is a real risk that may disappear. In 1987 the subsidies which they received for operating Avon's contract services amounted to £2.4 million but accounted for only some 8 per cent of their revenue (including total local authority support) from their bus operations. However, this underestimates the importance of contract services to BHL; Badgerline and City Line collected a further tranche of revenue from these services direct from passengers so that contract services in 1987 produced in total £4.3 million or over 14 per cent of their revenue from bus operations. Contract services are also very important to bus passengers in the specified area since they meet a variety of social needs not met by commercial services. In this context we have noted Avon's fear, given that its funds are limited, that if Badgerline and City Line did not continue to compete for its contracts, the effect would be to drive up tender prices leading eventually to some curtailment of contract services (see paragraph 6.30).

7.39. We noted in paragraph 7.25 that the fact that a growing number of small operators was competing for Avon's contract services had not allayed our concern about the loss of City Line as a major independent competitor for these services. The crucial requirement to keep tender prices down was that Badgerline and City Line should genuinely bid against each other.

7.40. Notwithstanding BHL's contention that there would be no loss of competition for Avon's contracts because Badgerline and City Line would continue to work independently, we expect that Badgerline's and City Line's bidding for Avon's contracts will be co-ordinated to the extent that it is commercially advantageous to do so. We conclude that unless this is prevented there is a real expectation that effective competition between Badgerline and City Line for these contracts will disappear as a result of the merger. This would mean the loss of one of the two principal bidders for the contracts as an independent competitive force; moreover we have found no prospective competitor of equal weight to City Line in the specified area.

7.41. We recognise that substantial benefits arise from the merger (see paragraphs 7.32 and 7.33) but in our view they are not sufficient to outweigh the serious detriments identified in paragraphs 7.31 and 7.40. We conclude therefore that the merger may be expected to operate against the public interest. The particular effect adverse to the public interest, which in our opinion the merger may be expected to have, is that as a result of a reduction in competitive tendering for the supply of County of Avon's contract services it will increase the cost to the County of supporting socially necessary bus services or, in certain circumstances, make it impossible for the County to support these services to the full extent that it would wish to support them.

7.42. As required by section 72(2) of the Act, we have considered in the light of our conclusion what action should be taken for the purpose of remedying or preventing the adverse effect we have identified. One possibility would be to require BHL to divest its acquisition of MRWH in whole, or in part by selling City Line to a third party. Such divestment would be an unnecessarily drastic remedy if there was a satisfactory alternative which would preserve the benefits arising from the merger. We therefore considered whether undertakings as to BHL's future behaviour would meet the public interest in this matter.

7.43. Although BHL maintained that the merger would not affect competitive tendering for contract services, it indicated in response to the Commission's invitation that it would be prepared, if necessary, to offer the undertakings set out in Appendix 7.1 to meet the Commission's concerns, first about the combined enterprises re-registering commercial services after losing a tender and second about the competitiveness of the prices tendered by Badgerline and City Line.

7.44. We do not think that the undertakings offered would satisfactorily alleviate the adverse effect we have identified (see paragraphs 7.31, 7.40 and 7.41). We believe that the first undertaking is too limited in its scope, both in terms of the

time limit and because it is restricted to situations in which Badgerline or City Line submit a tender for a subsidized service replacing one which either of them has deregistered. The second undertaking is principally unsatisfactory because, if the revenue is overestimated, BHL's proposed price formula can result in an excessive contract price, with a correspondingly excessive contribution to overheads and profit. Moreover the proposed powers for the auditor would be insufficient to deal with this difficulty. In order to meet these deficiencies we have suggested modified undertakings as set out in Appendix 7.2.

7.45. We recommend that the Director General of Fair Trading should seek undertakings from BHL on the lines set out in Appendix 7.2 or in such other form as may seem to him appropriate to alleviate the adverse effect. They would preserve many of the advantages available from competition for contract services. We do not believe that such undertakings would be unduly difficult or expensive to monitor.

7.46. We further recommend that if the Director General should be unable to obtain satisfactory undertakings within a reasonable period, which in our view should be not more than six months, the merger should not be allowed and BHL should be required to divest itself of MRWH in part by selling City Line to a third party or to dispose of MRWH as a whole to a third party.

D G GOYDER (*Chairman*)

L BRITZ

J D KEIR

N L SALMON

Professor S C Littlechild and Mr D P Thomson, being members of the Group, dissent from the conclusions for the reasons set out in the note of dissent included in this report

S N BURBRIDGE (*Secretary*)

16 January 1989

Note of dissent

Commercial services

1. Commercial services represent the predominant part of the bus network in the specified area, accounting for over 80 per cent of the revenue of the merged company. We agree with our colleagues that, since Badgerline and City Line did not actively compete in the provision of commercial services before the merger, the extent of competition between them in such services has not been reduced by the merger. Nor is there evidence that the merger is likely to reduce competition from other companies.

Contract services

2. Competition for contract services is unaffected in those parts of the specified area which are within the Counties of Wiltshire, Somerset and Gloucestershire (where City Line never bid for tenders before the merger). About 20 per cent of contracts by value are let by these Counties. We agree with our colleagues that the merger will remove a major competitor for contract services in the County of Avon. This is of particular concern for those contracts where the two companies have hitherto been the only bidders. However, on further investigation this detriment is less severe than at first appears.

3. First, contract services are only a small part of the total market for bus services. Subsidies from contract services and the related ticket revenue provided less than 15 per cent of BHL's total revenue in 1987. Bus subsidies themselves, which are the relevant point of concern for local authorities, cost Avon £2.9 million in 1987; this is less than one-tenth of total ticket revenues of all bus companies in the specified area.

4. Second, those contracts where the two companies are the only bidders represent a small and diminishing proportion of total contracts let. In Avon's initial round of contracts in autumn 1986, such cases accounted for about one-quarter of all contracts (45 out of 178). In the latest round of tendering, which was under way during our inquiry, only 5 out of 125 contracts received bids from only Badgerline and City Line.

5. Third, competition from other firms is pervasive and increasing. For example, the number of Avon's contracts with four or more firms tendering has increased from 15 per cent in 1986 to 52 per cent in 1988. The number of contracts with three or more independent firms tendering is also greater than it was before the merger. In autumn 1986, 38 per cent of contracts fell in this category, whereas in winter 1988 60 per cent of contracts had two or more bidders in addition to Badgerline and/or City Line (see Tables 3.2 and 3.4).

6. The contracts let in 1988 are not identical to those let in 1986. Nevertheless, the above evidence suggests that, although the merger has removed a major competitor for contract services in the County of Avon, this had occurred against a background of increasing competition from other bus companies. Costs of entry are low, and we are not convinced that size of company is a major consideration in the contract side of local bus operations. We also note that five other companies with fleets of over 250 vehicles currently supply commercial services in the specified area (see paragraph 3.14). Judged by number of tenders, competition for contract services has not in fact diminished since the merger, but rather has increased. There is no evidence that the merger has led to an increase in tender prices or to the withdrawal of socially desired services, nor is there now any reasonable expectation that it may be expected to lead to such detriments in future. Indeed, Badgerline argued that the efficiency gains and cost savings consequent on the merger would be reflected in *lower* tender prices.

Alleged anti-competitive practices

7. We have examined allegations that Badgerline engaged in anti-competitive practices. We accept that Badgerline's reinstatement to deregistered services without advance notice may have caused problems for others concerned.

However, we note the small scale of this problem: six services partially or wholly reinstated against 46 not reinstated, in the context of 298 contracts let by Avon since deregulation. We accept Badgerline's explanation that there were good operating reasons for the reinstatements in these cases. We do not believe that Badgerline's intention was either to manipulate the tender procedure to obtain subsidies for otherwise commercially profitable routes, or to threaten the firms actually awarded the tenders.

8. We accept that Badgerline's running of a temporary free bus service in Keynsham was a cause of concern for Norman Coaches. However, this was an isolated instance, occurring two years ago during the three-month transition period when Badgerline was precluded from registering the new service on a commercial basis. We note that Norman Coaches has not in fact been deterred from continuing to operate in this area.

9. At a time of significant changes in ownership, competition and regulation, there are bound to be some misunderstandings and misjudgments. We do not believe that the very few instances for which Badgerline has been criticized constitute a problem for competition when viewed in the context of Badgerline's operations as a whole. There is no evidence that they have deterred competition in commercial services and (as noted above) there is some evidence that competition for contract services has in fact increased, despite such incidents. Furthermore, we see no reason to believe that the merger will increase the number or severity of anti-competitive practices in future.

Undertakings

10. We have considered whether the public interest would be better safeguarded if BHL were to give undertakings of the kind volunteered or recommended.

11. As to the withdrawal and reinstatement of commercial services, we do not believe Badgerline's actions were anti-competitive in intention or effect. The Transport Act already provides for 42 days' notice of registration of new services. Since competitors do not seem to have been deterred by Badgerline's actions, a remedy is unnecessary. Furthermore, to prohibit Badgerline from reinstating services for an interval of one year could impair the efficient operation of bus fleets, reduce flexibility and adaptation to change, and needlessly prolong the payment of subsidies.

12. As regards bidding for contract services, we note that BHL's stated policy is for Badgerline and City Line to continue to prepare and submit independent bids. We agree with our colleagues that the parent company would be likely to co-ordinate bids from its subsidiaries if it were commercially advantageous to do so, and we agree with Avon that it would be extremely difficult to prevent this. We do not find it credible that the second undertaking proposed by BHL would significantly modify the bids submitted by the merged concern. The undertaking proposed by our colleagues has the additional features that the Director General may specify the overhead and profit mark-up on the two companies' bids, and that the excess of actual over estimated revenues should be payable to Avon together with the attributable contribution to overheads and profit. We believe that such price controls could lead to distortions in costing, bidding and ticketing processes; less efficient adaptation to changing circumstances; premature abandonment or renegotiation of contracts; and higher costs of monitoring. The higher costs incurred by the two companies would be reflected in higher tender prices, and the companies might question whether it was worth continuing to bid for as many contract services. Such effects would be adverse to the interests of Avon.

13. Bearing in mind these drawbacks and the increased number of bids for contract services, we do not believe that either variant of the second undertaking would materially improve the quality of competition for Avon's tenders. Given the market philosophy of the Transport Act, we also question whether it is desirable to establish such a precedent.

Benefits

14. The merger has already produced benefits and is likely to continue to do so. The reintroduction of the interavailability of tickets between Badgerline and City Line has been warmly welcomed by the public and local consumer organizations. Joint management of the bus fleet has increased efficiency of service. Rationalization of engineering facilities is expected to reduce engineering costs and release a major city centre site for redevelopment. Joint procurement of supplies and centralized administration have yielded savings worth over £500,000 a year. We therefore agree with our colleagues that the benefits of rationalization and the associated cost savings will be substantial.

Balance of public interest

15. The Government's policy, as set out in the White Paper and the Transport Act, was that the market could set the pattern of operation and ownership of the ex-NBC bus companies, subject to the normal considerations of competition policy. For the reasons given above, we believe that the merger between Badgerline and City Line has not reduced competition for commercial bus services. It has removed a major competitor for Avon's contract services, but the latest evidence suggests that, at least judged in terms of number of bids, this has been more than offset by increased competition from other bus companies. Consequently, we cannot accept that there is now a reasonable expectation that the merger will lead to an increase in tender prices or to the withdrawal of socially desired services. Indeed, it seems possible that cost savings consequent on the merger could lead to lower tender prices.

16. We do not find that Badgerline's reinstatement of a few commercial services was anti-competitive, and there is no evidence that it has deterred competition for contract services. We conclude that neither of the recommended undertakings is necessary to protect competition for contracts, and both undertakings have serious disadvantages.

17. The merger has already begun to yield benefits in the form of ticket interavailability, increased efficiency, rationalization, cost savings and redeployment of assets, and promises to provide more such benefits in future. We think it reasonable to give more weight to these benefits, which are expected to be substantial and which have already begun to materialize, than to the loss of a major competitor and the hypothetical possibility of future increases in tender prices in a small and decreasing number of cases, at a time when competition from other bus companies seems to be strengthening. We therefore conclude that the merger may be expected not to operate against the public interest.

S C LITTLECHILD

D P THOMSON

16 January 1989