

6 Conclusions

The merger situation

6.1. Under the reference dated 11 September 1990 (made under sections 64, 68(3) and 69(2) of the Fair Trading Act 1973-the Act), we are required to investigate and report whether a merger situation qualifying for investigation has been created in that enterprises carried on by or under the control of Bluebird Securities Ltd (incorporated in the United Kingdom) have within the six months preceding the date of the reference ceased to be distinct from enterprises carried on by or under the control of Caldaire Holdings Ltd. For this purpose, the terms of reference refer to the test specified in paragraph (a) of section 64(1) of the Act, the market share test, in respect of the supply of bus services,¹ in a specified area which is defined in the reference as the counties of Durham and Cleveland ('the reference area').

6.2. As stated in paragraph 2.29, Caldaire Holdings Ltd (Caldaire) acquired the entire issued share capital of Bluebird Securities Ltd (Bluebird) on 19 March 1990. Enterprises carried on by or under the control of Bluebird have therefore ceased to be distinct from those carried on by or under the control of Caldaire within the six-month period prior to our reference.

Jurisdiction

6.3. We are required by section 64(1)(a) and (3) of the Act to be satisfied that, as a result of these enterprises having ceased to be distinct, Caldaire supplies at least one-quarter of the bus services in a substantial part of the United Kingdom, or, if this was already the case, that the supply of these services by Caldaire is enhanced.

6.4. Caldaire objected (paragraph 5.8) to the basis of the reference area. It described the definition of the area by reference to county boundaries as 'arbitrary and irrational', and the exclusion of large areas-ie Tyne & Wear and North Yorkshire, in which Caldaire North East (CNE), its subsidiary most involved in the merger, operated-as arbitrary. Inclusion of such areas, Caldaire said, would have lowered the market share of the group to below the 25 per cent required to give the MMC jurisdiction. Caldaire has also argued that, taking into account a number of statutory provisions, in particular section 69(3) of the Act, the jurisdiction of the MMC is limited to the reference area; that the MMC has no power to amend the reference in relation to the reference area (or at all); and that, if the MMC should decide that the reference area was not lawfully drawn, the MMC should report that a merger situation qualifying for investigation had not been created. (Section 69(3) of the Act provides that, in relation to the question of whether the result mentioned in paragraph 6.3 has arisen, 'a merger reference may be so framed as to require the MMC to confine their investigation to the supply of goods or services in a specified part of the United Kingdom'; Caldaire claims that the present reference has been so framed, in respect of the reference area.)

6.5. We have considered, but are unable to accept, these submissions by Caldaire. While the point may, we recognise, be one which is open to argument, we are advised and consider that, on its true construction, the reference does not require the MMC, under section 69(3) of the Act, to confine their investigation to the supply of reference services in a specified part of the United Kingdom.

¹ As defined in section 159(1) of the Transport Act 1968, as amended by paragraph 1 of Schedule 1 to the Transport Act 1985.

6.6. We are further advised and consider that we are therefore not limited to considering the reference area in determining what is the appropriate area on the basis of which to approach the question of whether a merger situation qualifying for investigation has been created, and that this approach does not involve any amendment to the reference, but nor are we precluded from looking at the question in terms of this area. We have thus taken account of the reference area and of Caldaire's argument relating to the exclusion from the reference of further areas, ie the whole or parts of Tyne & Wear and/or North Yorkshire ('the wider areas'), in which Caldaire also operates services (paragraph 6.4).

6.7. The reference area includes virtually all those areas in which Bluebird operated and consequently the area primarily affected by the merger. Although we acknowledge that the reference area has transport and other links with adjacent areas (whether these do or not fall within the wider areas), this is most likely to be true of any area which may be under consideration by the MMC for the purpose of a reference. It is the case that the bulk of local bus services which operate in the reference area are operated solely within it. This reflects the local nature of the market for bus services and the importance of links between much of the area and the principal towns within it, such as Middlesbrough, Stockton, Darlington and Durham. In our view, therefore, the reference area in itself constitutes a reasonable basis on which to base our jurisdiction in this inquiry.

6.8. In considering Caldaire's argument as regards the wider areas, we have noted Caldaire's view that the delineation of an area such as the reference area should reflect the relevant market in which enterprises subject to the merger actually operate. We recognise that this is a factor to be taken into account and have done so. However, we believe and are advised that this consideration is not determinative of the appropriateness of an area which is being considered; in particular, we do not accept that this should correspond to the entire market served by those enterprises.

6.9. We have reviewed Caldaire's argument with this consideration in mind but, having also taken account of the positive factors relating to the reference area (paragraph 6.7), we are not persuaded that this was wrongly delineated or can be regarded as 'arbitrary' or 'irrational'. We see nothing unreasonable, in the circumstances, in the exclusion of Tyne & Wear in which Caldaire itself operates on a relatively limited scale accounting on the figures we have seen for only 1 to 2 per cent of registered bus miles in Tyne & Wear and some 10 per cent of CNE's turnover. Caldaire is the largest operator in some of the adjacent districts of North Yorkshire, but these are at some distance from Bluebird's operating areas and seem to us unlikely to be affected by the merger. Inclusion of these districts of North Yorkshire would, indeed, add to the size of the area, without significantly reducing Caldaire's market share.

6.10. We recognise that there are some parts of the reference area itself where one or both of the companies does not operate to any significant extent, but the exclusion of these would not, we think, materially affect Caldaire's market shares in the reference area, nor does the point itself support the argument relating to the exclusion of the wider areas.

6.11. We do not accept that the delineation of the reference area by reference to county boundaries is 'irrational'. The boundaries of the reference area reflect relevant administrative areas, the county councils having direct responsibility for contract bus services.

6.12. We therefore do not accept Caldaire's objections to the basis of the reference area and therefore to the validity of the reference itself. It is thus unnecessary for us to comment on what we consider would have been the consequences, or the correct approach for us to adopt, if we had accepted such objections.

6.13. We have concluded that it is reasonable and proper for us to carry out our investigation in respect of the reference area. Accordingly we now consider whether the reference area constitutes a 'substantial part of the United Kingdom', and, if so, whether the market share test is in other respects fulfilled. Caldaire has put forward detailed submissions, of law and fact, contending that the reference area does not constitute 'a substantial part of the United Kingdom', for the purpose of section 64(3) of the Act (paragraphs 5.2 to 5.7 above). We have considered these submissions and we have also had regard to the reasoning in a

number of previous published reports by the MMC which related to mergers of bus enterprises and which dealt with this point of the substantiality of an area.¹

6.14. We have looked at the matter afresh. However, we agree with the view taken in those reports that the words 'a substantial part of the United Kingdom' have to be considered in their statutory context, both in terms of section 64 itself, and of other relevant provisions of the Act, and also as a matter of general law. We have taken careful account of the detailed reasoning in the first of these reports. We acknowledge that the word substantial is a word in common usage and that attempts to define or explain it further are difficult and not necessarily helpful. However, as in those earlier reports, we also accept that as a general matter the word substantial may sometimes be used in a relative sense, ie important, real or substantive, as distinct from nominal, in relation to a larger whole, as well as in the sense of an absolute in terms of quantity or size. In the present connection, we believe that the former- ie important, real or substantive in relation to a larger whole- is the preferable meaning, and we have had regard to it in reaching our conclusion on this aspect.

6.15. We further consider, as in those previous reports, that the phrase 'a substantial part of the United Kingdom' involves both a quantitative and qualitative assessment. In considering what quantitative and qualitative elements should be taken into account for this purpose, we had regard to the size of the reference area; its population; its social, political, economic, financial and geographical significance; and whether it had any particular characteristics that might render the area special or significant.

6.16. As to quantitative elements relating to the reference area, it is roughly 1.2 per cent of the total area of the United Kingdom, and has a population of about 1.15 million, about 2 per cent of the population of the United Kingdom. It also includes the two county council areas of Durham and Cleveland.

6.17. In considering the elements that give the area its particular characteristics, we noted that it includes within Cleveland an area of considerable economic importance, with a particular concentration of some of the country's more capital-intensive industry, including one of the largest petrochemical complexes in Europe, extensive ICI plants, and the British Steel facilities at Redcar. The area also includes Teesport, the third most important port in Britain, and a number of North Sea support operations. There is a range of other manufacturing activities elsewhere in the area, although we were told that the county of Durham was in economic decline, particularly following the closure of many mines in the area. The City of Durham is, however, of both academic and cultural significance.

6.18. Having taken into consideration the various factors mentioned previously, we conclude that the reference area may be properly and correctly described as 'a substantial part of the United Kingdom' for the purposes of section 64(3) of the Act.

6.19. During the course of our inquiry, South Yorkshire Transport Ltd and South Yorkshire Passenger Transport Authority were granted leave to apply for judicial review in respect of the MMC's report on South Yorkshire Transport Ltd acquisitions (see paragraph 6.13). The respondents are the MMC and the Secretary of State. The issues in this application relate, firstly, to the proper construction of the words in section 64(3) of the Act, 'a substantial part of the United Kingdom', and to the proper basis for the definition of areas specified in the references relating to the inquiry concerned.

6.20. In view of the existence of these proceedings and issues, we considered whether we should make representations to the Secretary of State, under section 70(2) of the Act, for a further period in which to make our report. The date for the delivery of the report to the Secretary of State is 18 December 1990, apart from any such further period, and this could not exceed three months. However, although we understand that the proceedings are to be heard, in the High Court, in late January 1991, we cannot be confident that they would be finally determined and their outcome be capable of being properly taken into account before the expiry of any such further period (if granted). This would mean a protracted period of uncertainty for Caldaire as to the result of our inquiry. For this reason Caldaire itself expressed a preference

¹*Badgerline Holdings Ltd and Midland Red West Holdings Ltd*, Cm 595, March 1989; *Stagecoach (Holdings) Ltd and Portsmouth Citybus Ltd*, Cm 1130, July 1990; *South Yorkshire Transport Ltd acquisitions*, Cm 1166, August 1990; *Western Travel Ltd and G&G Coaches (Leamington) Ltd*, Cm 1226, October 1990.

for our completing the inquiry within the normal time-scale. After due consideration, therefore, we felt it appropriate to submit our report by the date required.

6.21. As shown in paragraph 3.6, two subsidiaries of Caldaire-Tees & District Transport Co Ltd (Tees & District), and United Automobile Services Ltd (United)-are estimated together to have accounted in April 1990 for about 38 per cent of registered bus miles in the reference area. The subsidiaries of Bluebird-Trimdon Motor Services Ltd (Trimdon) and Teesside Motor Services Ltd (Teesside Motors)-are estimated together to have accounted for about 10 per cent of registered bus miles in the reference area. The merger therefore increased Caldaire's market share in round figures from 38 to 49 per cent. The market share test having been satisfied, the reference requires us to exclude the alternative assets test presented in section 64(1)(b) of the Act.

6.22. We therefore conclude that the condition specified in section 64(3) is satisfied in respect of the supply of bus services in the reference area, being, in our view, a substantial part of the United Kingdom, and a merger situation qualifying for investigation has been created. We have therefore to investigate and report on whether the creation of that merger situation operates, or may be expected to operate, against the public interest.

The companies

Caldaire

6.23. Caldaire was formed in 1986 by the directors of West Riding Automobile Ltd, based in Wakefield, to facilitate a management buy-out of that company from the National Bus Company (NBC). In December 1987, Caldaire acquired United from the NBC, with operations in Cleveland, Durham and North Yorkshire, but extending also into Tyne & Wear. In February 1990, the name of United Automobile Services Ltd was changed to Caldaire North East Ltd (CNE) and its operations in Cleveland and Durham were transferred to the two wholly-owned subsidiaries, Tees & District and United Automobile Services Ltd, the latter being legally and commercially a different entity from the company previously having its name.

6.24. Caldaire told us that its objective was to develop efficient, low cost bus companies able to achieve the group's financial objectives. As discussed in paragraph 2.27, Caldaire sets its subsidiaries financial targets of 30 per cent return on capital employed, and 10 per cent profit (before interest) on turnover. CNE achieved a return on turnover of about 9 per cent in 1989. There was, however, wide variation in performance of individual depots, with losses at its depots in Middlesbrough and Hartlepool, which together also served Stockton.

6.25. Caldaire said that the long-term objectives of the company required high levels of capital investment. New investment in CNE had been low pending the re-establishment of its profitability, but adequate profitability having now been achieved, partly as a result of the present acquisition, CNE was planning to spend some £2.7 million on buses in 1991.

Bluebird

6.26. Until deregulation, Bluebird's only subsidiary operating local bus services had been Trimdon, a long-established operator based in the village of Trimdon in County Durham which also provided contract services for the National Coal Board serving local collieries. Following deregulation, the group expanded its operation into North Durham, Tyne & Wear where it set up a separate subsidiary Tyne & Wear Omnibus Company (TWOC), and Cleveland. It transferred its operations in Cleveland to a separate subsidiary, Teesside Motors, in November 1988. In 1989, TWOC was sold to Go-Ahead Northern (GAN), and immediately resold to Busways Travel Services Ltd (Busways), its main competitor in Tyneside. Bluebird has also had interests in continental coach tours (which were sold in 1986 and 1987) and express coach services; the merger we are considering involved the acquisition only of Trimdon and Teesside Motors.

6.27. Until the last few years, Trimdon was regarded as one of the most profitable bus operators in the United Kingdom. Trimdon's return on turnover in 1986, for example, was about 18 per cent, although the profitability of Bluebird as a whole was much lower. During later years, TWOC made substantial losses, offset to some extent by profits from Trimdon and Teesside Motors. In 1989 Trimdon made a return on turnover of 12 per cent, and Teesside Motors 3 per cent, an average for the two companies of about 6 per cent. Since the acquisition, the profitability of Trimdon and Teesside Motors is estimated to be significantly higher.

Reasons for the merger

6.28. Caldaire told us that the main objective of the merger was to remove what it saw as over-intense competition and inadequate profitability in Cleveland. Too many buses, in its view, had resulted in congestion, particularly in Stockton High Street and Middlesbrough Bus Station, deterioration in service and safety, and a financial situation in which neither Caldaire nor Teesside Motors could consider investment in new vehicles, and which could have led to Caldaire withdrawing from the market. It saw acquisition of Teesside Motors as the only option to remedy a situation which was also a matter of concern to local authorities and reported in the local press. It was understood that the owner wished to leave the business, and when approached was only willing to sell Teesside Motors together with the Trimdon operation.

6.29. Since the merger, the Trimdon operation has been fully integrated into United. The Trimdon depot was closed, and staff and vehicles transferred to other parts of United. Teesside Motors, on the other hand, is still operated as a separate subsidiary and its depot has been retained. There has, however, been a rationalisation of services involving Tees & District, Teesside Motors and Cleveland Transit (CT), the other main operator in Cleveland, leading to a withdrawal of some 50 buses in total in the Cleveland area. We were told that the rationalisation of services has already reduced congestion and contributed to sufficient improvements in profitability, to justify investment in new buses.

The market for bus services in the reference area

6.30. As we have acknowledged in previous reports, bus services remain a vital means of transport, essential to the mobility of significant sectors of the population. Available statistics suggest that use of buses is relatively high in many parts of the reference area.

6.31. The deregulation of the bus industry following the Transport Act 1985 has had significant effects in the reference area as elsewhere in the United Kingdom, although the structure of the industry is still evolving in response to deregulation. Within the reference area, the two former subsidiaries of the NBC are both privately owned, the former United operations in the area are now part of the Caldaire group, and Northern General Transport has been sold to a group of directors and senior managers who formed GAN as a vehicle for the purchase. The former municipal bus companies-CT, Darlington Transport and Hartlepool Transport-remain owned by local authorities but are required to operate on an arm's length basis. There is provision in the 1985 Act for these companies to be sold should the local authorities decide to do so.

6.32. Deregulation also introduced competition into the operation of commercial bus services, and contract services subsidised by county councils. As in other parts of the United Kingdom, the extent to which competition has developed has varied. In both Durham and Cleveland, much of the stimulus to competition has come from a number of smaller operators, notably Trimdon itself, who have expanded their activities to develop commercial services in competition with the established firms, and from new entrants to the market. Within County Durham, for example, competition to United developed on a number of routes including those between Durham city and Bishop Auckland, and between Newton Aycliffe and Darlington. Within Cleveland, Teesside Motors and a number of other new entrants competed primarily with CT resulting in intense competition between three main operators on many routes in Stockton and Middlesbrough, and with as many as five or six operators competing on some routes. Some of the new entrants have subsequently withdrawn from the market, or reduced their activities. In part of East Cleveland, however, United has retained a very strong position, despite some competition from CT.

6.33. OK Motor Services Ltd (OK), formerly the largest of the independent operators in the reference area, based in Bishop Auckland, has much expanded its activities since deregulation, establishing a depot at Peterlee, although mainly by operating contract services or commercial routes not served by other operators. It has also recently extended its operation into Stockton. There has, however, been little competition between the former NBC subsidiaries, United and GAN, which have tended to remain within their long-established operating areas, GAN to the north of the city of Durham, and United to the south-but with some joint services between these areas. There has been more active competition between United and some of the municipal operators, United developing a number of new services in Hartlepool and Darlington. Caldaire told us that because it was concentrating on competition elsewhere in the reference area, it had tended not to initiate active competition with CT following deregulation, but it had responded to competition initiated by CT in East Cleveland, both on the routes affected and on other routes. CT had subsequently withdrawn most of its commercial services in East Cleveland.

The effects of deregulation

6.34. Competition resulted in significant increases in frequency on many routes. One study we have seen, for example, suggested that the number of bus trips in Stockton increased by over 90 per cent between October 1986 and April 1987, and, as shown in Table 3.11, frequencies increased by as much as 100 per cent on a number of routes in Middlesbrough. There were similar increases in frequency on some routes in County Durham, for example between Durham and Coxhoe. On the other hand, it was suggested that the extent of competition brought some costs, particularly of traffic congestion in Stockton and Middlesbrough.

6.35. The level of fares charged has not been a significant feature in competition between the companies, although there are a number of instances of Caldaire and CT reducing fares to match competitors, we were told, not to undercut them. Caldaire, for example, charged somewhat lower than standard fares on routes operated in competition with Trimdon. More generally (as shown in Appendix 3.2) Caldaire has responded to competition by changing the timing of its services, or increasing frequencies.

6.36. A main benefit of deregulation and competition, as elsewhere in the United Kingdom, has been to provide a stimulus to bus operators to improve efficiency. There have, for example, been significant increases in the efficiency of CT since deregulation. Caldaire also acknowledged that the spur of actual and potential competition encouraged management to improve cost effectiveness and profitability.

Contract services

6.37. It has been the policy of both Cleveland County Council (CCC) and Durham County Council (DCC) to maintain broadly the same level of bus services as existed prior to deregulation. Contract services currently account for some 13 per cent of registered bus miles in Cleveland and 15 per cent in Durham. In particular, works, schools, early morning and Sunday services and many rural services remain dependent on the support of the two county councils. The current annual cost of subsidies for contract services in Cleveland is somewhat over £1 million per year, and in Durham is about £1.7 million. Deregulation has generally brought significant savings in local authority expenditure on bus services. The level of subsidy in Durham has reduced significantly over the last four years, partly as a result of increased competition for tenders, but also because some previously tendered services have been registered as commercial; hence there is not a clear distinction between commercial and contract services. The ability of county councils to support services provides a degree of safeguard for passengers should a dominant operator reduce services, but the funds available to do so may in time prove limited.

The effects of the merger

Market shares

6.38. As was shown in Table 3.3, before the merger Caldaire was the largest operator in the reference area, its subsidiaries, United and Tees & District, accounting for an estimated 38 per cent of registered bus miles. GAN and CT are each estimated to account for about 12 per cent of bus miles. Bluebird, through its subsidiaries Trimdon and Teesside Motors, was the fourth largest operator, with some 10 per cent of bus miles. As a result of the merger Caldaire is estimated to account for some 49 per cent of registered bus miles in the reference area but a somewhat lower share of turnover from registered bus services-some 45 per cent.

6.39. Market shares, however, vary widely by district. As shown in Table 6.1, Bluebird's share of bus miles was highest and the effect of the merger most pronounced in the Durham, Easington, and, in particular, Sedgefield local authority districts of County Durham (which we refer to as 'South-East Durham'), and in the Middlesbrough, Stockton, and, to a lesser extent, Langbaugh districts of Cleveland (which we refer to as the 'Teesside area').

TABLE 6.1 Shares of registered bus miles in individual districts, April 1990

	<i>per cent</i>					
	<i>United/Tees Others & District</i>	<i>Trimdon/ Teesside Motors</i>	<i>Combined enterprise</i>	<i>Largest other operator</i>		
				<i>Name</i>	<i>% share</i>	
County Durham						
Chester-Le-Street	9	0	9	GAN	68	23
Darlington	56	0	56	Darlington	37	7
Derwentside	1	0	1	GAN	68	31
Durham City	57	6	63	GAN	14	23
Easington	35	10	45	GAN	30	25
Sedgefield	36	20	56	Eden	10	34
Teesdale	33	0	33	OK	50	17
Weardale	33	3	37	OK	36	27
Cleveland						
Hartlepool	39	2	41	Hartlepool	54	5
Langbaugh	78	6	84	CT	16	0
Middlesbrough	38	20	58	CT	33	9
Stockton	19	25	44	CT	41	15

Source: MMC study.

6.40. Caldaire argued that regard should be had, in estimating market shares, to the supply of unregistered as well as registered bus services-ie certain school, works and other private hire contracts in which no fares are collected on boarding. We accept that there is a degree of overlap between the two markets-some employees, for example, may have an option of travelling to work on a coach hired by the employer, or on a registered bus service-but the markets seem to us largely separable: shoppers, for example (except for limited 'free bus' services operated by some out-of-town supermarkets), would have little option but to use registered bus services. The nature of competition for the two types of service is also different, small operators competing more strongly for contracts for unregistered services, and a number only competing for such contracts.

6.41. We also considered competition from other forms of transport. There is a network of rail services in the reference area but this is of limited relevance in the districts affected by the merger. There are few railway stations in South-East Durham, and in the Teesside area stations are generally confined to town centres and industrial sites rather than main residential areas. Rail services are also less frequent than buses, in particular those on the Middlesbrough-Whitby line having recently been reduced to four per day. One of the other main operators described competition from rail as insignificant, suggesting also that rail services in the area were unreliable.

6.42. The main competition in the longer term has been from the switch to use of cars. However, available statistics suggest that in the reference area car ownership is lower than the national average, and buses are widely used by the population. Although taxis may provide an alternative for some users, who are prepared to co-ordinate their journey and share a taxi, for many people there is no real alternative to buses.

6.43. Caldaire also pointed to the general price sensitivity of the market, most bus users coming from the less affluent sections of the population and a high level of fares therefore being likely to depress use of buses. We have no reason to doubt Caldaire's policy of keeping fares low, but consider that an operator in a dominant position, with, for example, over one-half of the market in some areas, is likely to be under less pressure to reduce costs, and freer to raise fares or reduce levels of service than one in a competitive situation. It may indeed be profitable for him to do so, even with some loss of passengers. We believe therefore that the overall sensitivity of the market is likely to prove a weaker constraint on the performance of a bus operator than the maintenance of competition from other bus operators.

6.44. On balance, therefore none of these more general factors detract from the need to examine the effect of the merger on competition between operators of registered bus services.

The effect on competition

6.45. The Bluebird subsidiaries, Trimdon and Teesside Motors, operated in very different operating environments. We have considered the effects of the merger in the Teesside area and in South-East Durham respectively.

Teesside area

6.46. As shown in Table 6.1, following the merger, Caldaire is estimated to account for about 44 per cent of registered bus miles in Stockton, 58 per cent in Middlesbrough, and 84 per cent in Langbaugh, although Teesside Motor's operations in Langbaugh were confined to the western part of Langbaugh, between Middlesbrough and Eston. CT is estimated to account for a market share similar to that of Caldaire in Stockton-some 41 per cent; but lower shares in Middlesbrough and Langbaugh, 33 per cent and 16 per cent respectively. Particularly in Middlesbrough and Stockton, therefore, the effect of the merger is to reduce the number of main operators from three to two, although there are also a number of minor operators in these towns.

6.47. Teesside Motors, although the third largest operator in the Teesside area, would appear to have been the most active competitor. Competition was clearly greatest between Teesside Motors and CT. Some 90 per cent of Teesside Motors' route miles overlapped with CT, while some 60 per cent overlapped with United. We were told that Teesside Motors' policy was largely to duplicate CT's services operating the same routes, with the same route numbers, at similar times.

6.48. On most services in the Teesside area there remain two or more operators. Teesside Motors was in competition with United alone on only about 5 per cent of its route miles, hence there has been very little elimination of competition. The bulk of Teesside Motors services continue to run in parallel with those of CT, and on about one-quarter of routes there is also competition from independents.

6.49. The effect of the merger has, however, been to remove the most active competitor, producing high combined market shares of registered services of the two main operators of almost 100 per cent in Langbaugh, 91 per cent in Middlesbrough and 85 per cent in Stockton. We considered, therefore, to what extent the merger could be regarded as giving rise to a 'duopoly', with limited competition between the two main operators.

6.50. The suggestion was put to us that there was a formal market sharing agreement between Caldaire and CT. This was firmly denied by both companies. Nevertheless, following the merger, there has been a rationalisation of services between the two companies, with agreements to provide regular joint services on routes between Middlesbrough and Eston, Netherfields and Acklam. The operators are, however, free to run services at other times. There are no fares agreements (although similar fares tend to be charged by the

two operators), nor is there any sharing of revenue; the agreements are not therefore regarded by the Office of Fair Trading (OFT) as registrable under the Restrictive Trade Practices Act 1976.

6.51. Passengers still, however, have a choice of buses provided by different operators, and indeed would seem to benefit from operators agreeing to time the services at regular intervals, rather than each trying to run a minute or two in front of the other. We also accept, as Caldaire suggested, that there is still scope to compete on quality of service, in particular on reliability, and standard of vehicles: Teesside Motors may even be a somewhat stronger competitor given Caldaire's intention to invest in larger-capacity, double-deck buses. Caldaire also told us that it would welcome any opportunity to improve its market share, should CT's performance deteriorate. Caldaire has indeed shown itself prepared to initiate competition with local authority operators in Darlington and Hartlepool, and CT also initiated competition with Caldaire in Redcar. In our view, there would seem insufficient evidence to enable us definitively to characterise the relationship between Caldaire and CT as a 'duopoly', although competition between them has not at all times been particularly strong and the acquisition of Teesside Motors may to a limited extent therefore weaken competition to both companies.

6.52. Overall, we believe that there is still sufficient competition between Caldaire and CT to provide a stimulus on both operators to limit fares, and to maintain or improve their efficiency and their frequency and quality of service. There are also a number of other operators in the Teesside area, with up to five operators on some routes.

South-East Durham

6.53. As also shown in Table 6.1, following the merger Caldaire is estimated to account for about 63 per cent of registered bus miles in the district of Durham, 45 per cent in Easington and 56 per cent in Sedgfield. The local authority districts, however, contain a number of distinct towns and villages, separated by rural areas, and do not appear to dictate the pattern of bus travel. For example, the Sedgfield local authority includes the apparently distinct areas of the Trimdons and Newton Aycliffe; the Trimdons' most frequent bus links are with Peterlee about 8 miles to the North-East, Newton Aycliffe's with Darlington about 7 miles to the South. The impact of the merger would also seem to vary within, as well as between, these local authority districts.

6.54. The merger has had a particular effect on the area within a radius of about 5 miles of Trimdon (the 'Trimdon area'), where the acquired company's depot was situated, and on services between the Trimdon area and the surrounding towns of Durham, Peterlee and Stockton. This area contains a number of villages (the Trimdons, including Trimdon Village, Trimdon Colliery, Trimdon Grange and Deaf Hill; Wheatley Hill and Thornley; Wingate and Station Town; Coxhoe; Kelloe; West Cornforth; Fishburn; and Sedgfield) with a total population of about 30,000. Before the merger, daytime services were operated mainly by United, Trimdon and Favourite, an operating division of Busways which, we were told, set up services in South-East Durham in response to competition from TWOC in Newcastle. Busways acquired TWOC in November 1989, and in March 1990 (about the time of the merger we are considering) began to withdraw its commercial services in South-East Durham. Favourite's presence in the Trimdon area could therefore be regarded as relatively transient, attributable in part to Bluebird's own competitive activities outside the reference area. The effect of competition from Favourite had, however, been both to increase frequencies on a number of routes and to develop new routes served by minibuses.

6.55. Caldaire described competition between Trimdon and United before the merger as 'gentle'. Trimdon, however, charged lower fares than United's general fares scales, and Caldaire told us that United matched those lower fares on routes on which it competed with Trimdon. Since the merger the previous differential between these routes and United's general fares levels had been maintained. DCC, however, described the loss of competition in this area as a result of the merger as 'significant'.

6.56. Following the merger, Caldaire is estimated to account for about 70 per cent of bus miles in the Trimdon area. We are aware of seven other operators of services running through the Trimdon area, including OK, Favourite (which continues to run one contract service through the periphery of the area), and some small local companies. These operators, however, mainly operate routes not operated by Caldaire, or contract services particularly at early morning, evenings and on Sundays. In particular, the effect of the merger and Favourite's subsequent withdrawal from commercial services has been largely to

remove competition on the main regular daytime services within the Trimdon area, for example through Trimdon itself, and between that area and Durham, Peterlee and Stockton. Appendix 3.5 lists some of the routes affected, including Durham-Coxhoe, Trimdon-Sedgefield, Trimdon-Peterlee, and Sedgefield-Stockton. The loss of competition therefore affects both services within the Trimdon area, and between the Trimdon area and surrounding towns, including, for example, intermediate villages such as Shincliffe and Bowburn.

6.57. There are a number of other operators based within 10 miles of the Trimdon area, and we discuss in paragraph 6.65 whether potential competition from other operators is likely to be sufficient to offset the loss of actual competition and choice that has resulted from the merger.

The effect on competition for contract services

6.58. Caldaire and Teesside Motors received about 61 per cent of the subsidies paid for contract services in Cleveland (Table 3.9), and Caldaire and Trimdon accounted for some 22 per cent of subsidies paid for contract services in Durham (Table 3.7). In Cleveland competition between Teesside Motors and Caldaire in bidding for contracts has been relatively limited. In September 1989 the two companies tendered against each other for only 12 of 89 schools and works contracts awarded; and in April 1990 for 10 out of 42 daytime, evening and Sunday contracts awarded. Over a dozen other operators competed for tenders in the most recent tender rounds, with an average of almost three tenderers per contract and an average of 4.5 tenderers per contract for those tenders for which both United and Teesside Motors competed.

6.59. In Durham, Caldaire and Trimdon competed against each other for only 11 out of 218 contracts awarded in April 1990. There is also extensive competition from other operators for tenders, with 5.6 bids per contract in the last tender round (including different combination bids from the same operators). Competition is particularly strong in the south of the county, and contracts have, for example, been won by OK and Griersons Coaches for tender services through the village of Sedgefield itself.

6.60. The merger therefore has only a limited effect on competition for contract services, and there is evidence of strong competition from other operators. Indeed, neither county council expressed concern about the effects of the merger on contract services.

The effect on potential competition

6.61. As well as the effect on actual competition between Bluebird and Caldaire, we considered whether the merger could affect potential competition on services not operated by one or other of the companies at the time of the merger. Bluebird was an active and effective competitor, having expanded since deregulation both into Tyneside and Teesside. It could therefore be regarded as a main potential competitor elsewhere in the reference area (eg Durham, Hartlepool, Darlington or Redcar), although it had withdrawn from Tyneside, outside the reference area, following fierce competition from Busways which extended into Trimdon's own home territory.

6.62. There have been other companies in the area which have extended their services to compete with incumbents, eg OK (into Teesside and, mainly in contract services, Peterlee), Gardiners (on Bishop Auckland-Durham), CT (into East Cleveland) and Caldaire itself (into Hartlepool and Darlington). These could also be considered as potential competitors elsewhere in the reference area, but many have subsequently scaled down their competition (Gardiners withdrawing from the Bishop Auckland-Durham route and CT from most of its commercial services in East Cleveland) following the incumbent's response. From the evidence presented to us, it is clear that many smaller firms do not wish to enter into strong competition with the larger companies, and the larger companies themselves, particularly the former NBC operators, are also reluctant to initiate competition. In our view, therefore, the merger, by removing the fourth largest operator within the reference area, and one with a record of active and effective competition, has also removed a main source of potential competition on other services in the reference area which may not be directly affected by the merger.

Whether competition could have been sustained

6.63. Caldaire has pointed to the poor financial performance of its own services in the Teesside area. It further argued that Teesside Motor's level of profitability was insufficient to fund replacement of its buses. In our view, however, the prospects for either company should the merger not have proceeded are too uncertain for us to be able to assume with confidence that competition could not have been sustained.

6.64. Teesside Motors was marginally profitable (with profits of 3 per cent on turnover in 1989), and it is by no means clear to us that it would have been unable to secure replacement second-hand vehicles or to continue to operate its existing fleet for several more years. Nor can we exclude the possibility of Teesside Motors finding an alternative buyer, acquisition of an existing operator still being an attractive method of new entry into local bus markets. Trimdon was also relatively profitable (with profits of 12 per cent on turnover in 1989) and could have maintained its operations in the Trimdon area.

Potential competition from new entrants

6.65. The prospect of new entry into the areas affected by the merger can clearly not be discounted altogether. Over two dozen firms have entered the market or significantly expanded their operations in Durham since deregulation, and there have been other new entrants in Cleveland although a number of these entrants subsequently withdrew from the market altogether, or from particular services on which they competed with United.

6.66. The costs of entering the market would not seem to represent a significant barrier to entry, inexpensive second-hand buses being readily available. However, the evidence we have received suggests that it is more difficult for a new entrant to stay in the market in direct competition with established operators. Bus operators to whom we spoke referred in particular to the prospect of the incumbent's response as a main deterrent to entry. Within the reference area, there have been several instances of response to new entry, by increased frequency and retiming services, but also by matching if not undercutting of fares on the new routes operated by an entrant. There have also been instances of retaliation on the entrant's own 'territory'. Caldaire itself is clearly prepared to respond to competition in order to defend its position on the most profitable routes. It acknowledged that the former NBC and municipal companies outside the area were not currently an imminent threat.

6.67. As regards the Teesside area, therefore, although there are a number of independent operators, including OK, a recent new entrant to that market, we cannot automatically assume that they would risk further expansion should the performance of the major operators deteriorate. We have not therefore put any weight on the strength of potential competition in reaching our conclusions as regards the effects of the merger in the Teesside area.

6.68. Similarly, although there are a number of operators based in the Trimdon area and elsewhere in South-East Durham, we think it unlikely that they would wish to enter into competition with Caldaire on those routes serving the Trimdon area most affected by the merger. It would not seem a particularly attractive area for new entrants, being primarily rural with relatively infrequent services and, it was suggested to us, a likely decline in bus use. The threat of retaliation may inhibit not only small operators but also the larger operators, such as GAN or OK, who would also risk response on their more profitable routes in their own established operating areas. We would not therefore regard the prospect of potential competition from other operators as sufficient to offset the loss of actual competition as a result of the merger on routes serving the Trimdon area.

The effects on other operators

6.69. The suggestion was made to us that Caldaire would be in a stronger position to operate anti-competitively against existing operators as a result of this merger. Caldaire clearly respond actively to competition when challenged-by matching, but not undercutting, competitors' fares, or more often by increasing frequencies-but has argued that it does not do so in an anti-competitive manner, and we have no evidence to the contrary. We are not convinced that the merger significantly increases Caldaire's ability to act anti-competitively against existing competitors, or the likelihood that it will do so. Smaller operators may on the other hand benefit from a reduction in competition as a result of the merger since any reduction in frequency of Teesside Motors and CT would benefit the loadings of other operators on these routes.

The effects on fares, or levels or quality of service

6.70. As discussed in paragraphs 6.34 to 6.36, in our view competition is to the benefit of bus users, providing a main stimulus to the efficiency and level of service of bus operators. Weakening of competition, or of potential competition, may therefore be expected to reverse some of the beneficial changes since deregulation, and remove some competitive constraints on costs and fares as well as much of the stimulus to improved levels or quality of service.

6.71. We received complaints that since the merger services have deteriorated in some parts of South-East Durham with some services withdrawn or cancelled, irregular running and incorrect routes. As regards the level of services offered, some services have, however, improved and there would not seem to be any overall decline. DCC, indeed, thought that it could remedy the particular problems that had arisen. In Teesside, there clearly have been reductions in frequency on some routes, although with the benefit claimed by Caldaire of relieving congestion at Stockton High Street and Middlesbrough. Moreover, market research carried out for Caldaire suggests that the bulk of passengers do not feel they have been adversely affected by the merger. As regards the quality of service, Caldaire accepted that there was a serious deterioration in South-East Durham immediately after the merger, as a number of Trimdon drivers who had been expected to transfer to other depots left the company instead. It told us, however, that these problems had proved temporary. We do not therefore find that there is sufficient evidence that the merger has already had adverse effects on services, although the problems that have occurred confirm the importance to users of the level and quality of services provided, and the consequences of a dominant operator not maintaining acceptable services. We also note the more general increase in the number of complaints about quality of service of both United and Tees & District since deregulation (see paragraph 3.41).

6.72. In our view, however, any significant reduction of competition may in the longer term be expected to have adverse effects on passengers and, in particular, weaken the constraints over the fares that can be charged, and remove the stimulus provided by competition to maintain and improve the levels and standards of service provided.

Possible benefits

6.73. Caldaire has stressed the benefits of the merger, in particular reduced congestion in the Teesside area, higher investment in vehicles, better standards of vehicles and safety, and improved quality and reliability of service. However, we consider that congestion could have been reduced by the authorities using the powers available to them. Safety and vehicle maintenance are the province of the Traffic Commissioners, whose powers have been devised in order to maintain adequate safety standards and who have in many cases removed buses from operation when maintenance standards were inadequate. We do not believe that these are issues that can be used to justify any further concentration of the local bus industry, or reduction in competition in bus services. Similarly, we do not believe that the benefits of investment in new vehicles would necessarily be sufficient to offset the adverse effects of any reduction in competition. One study we have seen suggested that passengers perceived other benefits from increased competition in Stockton-for example, from increased frequencies-the loss of which could offset any benefits from operating new vehicles.

Conclusions

6.74. In our view, therefore, there is insufficient evidence that the merger has as yet operated against the public interest in the Teesside area. In this area we believe that there is sufficient competition between Caldaire and CT, and other operators on certain routes, to prevent adverse effects in the longer term. Competition has not been significantly affected by the merger in Teesside, and Caldaire being an efficient operator, and prepared to invest if it earns adequate profits to do so, and congestion having been relieved, there are indeed a number of benefits arising. We do not believe that the merger has operated or may be expected to operate to the detriment of the public interest in Teesside.

6.75. In South-East Durham, however, the effect of the merger has been the removal of choice and competition on a number of routes operating into and within the Trimdon area. We do not believe that potential competition from other operators, or the sensitivity of passenger behaviour to fares or service levels, represent as strong a constraint on performance as the maintenance of competition. We also do not think it sufficient to rely on the county council to provide contract services should there be any deterioration in performance of Caldaire's commercial services in the area: it would not seem appropriate to rely on public expenditure to remedy loss of competition between private sector operators, and funds available to support local bus services may in time prove limited. We do not dispute Caldaire's current intention to maintain low fares and good services on these routes. However, the removal of competition on a number of routes serving the Trimdon area, including services within this area and between this area and other towns, removes a main constraint on fares and a main stimulus to efficiency and to the maintenance and improvement of services on these routes, and this loss of competition is likely to lead to higher fares, lower standards, quality and frequency of service and less choice than would be expected to occur in a more competitive situation. We also find that the merger has resulted in a loss of potential competition in other parts of the reference area. We are not persuaded that any benefits of the merger are sufficient to outweigh these adverse effects.

6.76. We conclude therefore that the creation of the merger situation we have identified may be expected to operate against the public interest by reason of the particular effects adverse to the public interest identified in paragraph 6.75, namely the removal of competition, less choice, higher fares, and lower standards, quality and frequency of service on a number of routes serving the Trimdon area, and loss of potential competition elsewhere in the reference area. We are therefore required to consider what action, if any, should be taken for the purpose of remedying or preventing these adverse effects, and may, if we think fit, make recommendations as to such action.

Recommendations

6.77. The adverse effects we have identified in paragraph 6.75 arise primarily on routes serving the Trimdon area in South-East Durham: remedies should relate mainly to Caldaire's operations on these routes. Divestment of the Bluebird assets acquired would be a disproportionate remedy to the adverse effects we have identified.

6.78. We also do not believe that divestment would provide a practical remedy to the adverse effects we have identified in this case. The Trimdon operation has been fully integrated into Caldaire, vehicles have been distributed elsewhere in Caldaire and some withdrawn, some staff have been transferred within Caldaire, and others have left. The former Trimdon depot is, we understand, still to let, but it would be exceptionally difficult to reconstitute the former Trimdon operation. South-East Durham would moreover be a difficult area for a purchaser to re-establish services, unless Caldaire were to decide to withdraw or be required to withdraw its own services in competition with those of a purchaser, hence removing any intended benefits to competition. We believe therefore that there is little or no prospect of re-establishing the competition that existed before the merger. A requirement to divest could also impose some financial cost upon Caldaire, if it was unable to recover a sufficient part of its original purchase price, which could in turn adversely affect its other services, outside the area in which we have found adverse effects.

6.79. Caldaire, while claiming that any adverse effects were minor and heavily outweighed by the advantages of the merger, said that it would be prepared to enter into a number of undertakings which would be consistent with its existing policies but would remove the main concerns as to the effects of the

merger. In our view, a number of these undertakings go a considerable way to remedying the adverse effects we have identified.

6.80. One of the adverse effects we have identified is on the level of fares, and services on routes serving the Trimdon area. We do not believe that a formal system for regulation of either fares or services would be desirable in the longer term, unless there was evidence that a dominant operator was already abusing its position. Such a system would be complex and expensive to administer, inflexible to changes in circumstances, and indeed could put at risk some of the benefits of deregulation. Caldaire suggested, however, that it would be prepared to agree undertakings that would limit fares increases, and reductions in service, for a two-year period, and in our view such undertakings would provide some reassurance that adverse effects on fares and services would not arise in the short term. We therefore recommend that Caldaire be required to agree undertakings with the Director General of Fair Trading to the effect, that:

- (a) Caldaire will not for a period of two years deregister any existing services on routes serving the Trimdon area (as defined in paragraph 6.54) save with the consent of the Director General of Fair Trading. Caldaire further said that it would only seek such consent if it experienced a significant decline in patronage, or where such a decline was anticipated due to extraordinary factors such as the closure of a school or factory served by any route. It would be for Caldaire to provide supporting evidence of any such expected decline in traffic.
- (b) For a similar two-year period, Caldaire will only increase fares once in any year on routes serving the Trimdon area and by no more than the increase in Retail Price Index since the date of the previous fares increase. For simplicity, Caldaire proposed that such an undertaking would apply to each element of the fares structure, which would to us seem a feasible approach given the limited duration of such undertakings.

These undertakings should, in our view, apply to all routes serving the Trimdon area, including services and fares within, to and from the Trimdon area and all intermediate journeys on those routes, for example between Durham and Shincliffe, Bowburn and Coxhoe, Stockton and Sedgefield, Trimdon and Peterlee.

6.81. We are, however, concerned that the merger may have longer-term adverse effects, beyond the period for which undertakings as to fares or levels of service may be feasible. We believe therefore that they should be supplemented by the approach, which we have recommended in previous inquiries, of improving the accountability of Caldaire's operation in the area most affected by the merger. Such an approach would, we believe, provide considerable reassurance as to Caldaire's intention and performance over the longer term, and enable any abuse of its position to be detected, and action to be taken to control any such abuse. We suggest therefore that Caldaire undertake to provide information on an annual basis to the OFT and DCC on main aspects of performance of Caldaire on routes serving the Trimdon area such as the mileage operated on these services, both commercial and contract, and indications of quality of service such as the percentage of scheduled services actually operated; and also provide advance notification of any changes in fares or services. We also suggest that annual information be provided to the OFT on the financial performance of Caldaire's operations on routes serving the Trimdon area and/or of the depots involved.

6.82. The encouragement of competition from other operators is one of the most effective means to remedy the loss of competition resulting from a merger, and the prospects of competition would be increased if undertakings were agreed which would limit the scope for the incumbent operators to retaliate against new entrants by temporary reduction in fares or increases in frequency. Caldaire, although it denied such undertakings would be necessary, said that it was prepared to offer a two-year undertaking that where frequencies were increased or fares reduced in response to competition on a particular route, such increases in frequency or reduction of fares would be sustained for 12 months from the date of it taking such action. We recommend that Caldaire be required to agree undertakings with the Director General of Fair Trading to the effect that:

- (a) if Caldaire reduces fares to below those of a competitor on any route or part of a route serving the Trimdon area, it will not subsequently increase fares should the competitor withdraw for a period of at least one year after the competitor's withdrawal; and
- (b) if Caldaire increases its frequencies on any routes or part of a route serving the Trimdon area operated by another company, or on which another company has announced its intention of operating services, should the competitor withdraw it will not subsequently reduce commercial frequencies for a period of one year after the competitor's withdrawal.

Caldaire expressed concern that other operators would use such a constraint on Caldaire to their advantage, entering a route temporarily, but leaving Caldaire running uneconomically once they had withdrawn. We would not, however, think it appropriate to limit the period of such an undertaking to two years, as suggested by Caldaire for this reason, but Caldaire should, we believe, be able to seek release from this undertaking should circumstances change in the Trimdon area, or should Caldaire, for example, be seriously disadvantaged by smaller operators temporarily operating routes in such a way.

6.83. As in other cases, a difficulty shown by our consideration of remedies is that a merger has taken place and the acquired company has been integrated, and it is unlikely to be feasible to reverse the merger, to divest the assets acquired, and re-establish the competition that existed before the merger. The merger has significantly diminished competition in South-East Durham and has reduced potential competition in other areas; further acquisition could have similarly damaging effects in Durham and Cleveland, accentuating the adverse consequences of the present merger. We consider therefore that the present merger makes further acquisition of its competitors by Caldaire in the reference area in principle undesirable. Notification of mergers to the Director General of Fair Trading is still not compulsory and it may therefore be difficult to take action until it is too late adequately to remedy any adverse effects.

6.84. We recommend therefore that Caldaire be required to agree undertakings with the Director General of Fair Trading that it will not make further acquisition of any companies operating services from a depot within the reference area, without prior notification to the Director General of Fair Trading.

6.85. We believe that the combination of measures we have proposed-to limit price increases or reduction in service for a period of two years (paragraph 6.80), to improve accountability (paragraph 6.81), to limit the scope for retaliation against new entrants or other competitors by temporary reductions in fares or increases in services (paragraph 6.82), and to pre-notify further acquisitions (paragraph 6.84)-would effectively remedy the adverse effects of the merger in South-East Durham that we have identified.

J S BRIDGEMAN (*Chairman*)

L BRITZ

M R HOFFMAN

P K R MANN

S N BURBRIDGE (*Secretary*)

18 December 1990