



Neutral citation [2010] CAT 14

**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Case Number: 1145/4/8/09

Victoria House  
Bloomsbury Place  
London WC1A 2EB

21 May 2010

Before:

VIVIEN ROSE  
(Chairman)  
PROFESSOR ANDREW BAIN OBE  
MICHAEL BLAIR Q.C.

Sitting as a Tribunal in England and Wales

BETWEEN:

**STAGECOACH GROUP PLC**

Applicant

- v -

**COMPETITION COMMISSION**

Respondent

Heard at Victoria House on 9-10 March 2010

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**JUDGMENT (Non-Confidential Version)**

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Note: Excisions in this judgment marked “[...][C]” relate to passages excluded having regard to Schedule 4, paragraph 1 to the Enterprise Act 2002

## APPEARANCES

Mr. Rhodri Thompson Q.C. and Mr. Christopher Brown (instructed by Maclay Murray & Spens LLP) appeared for the Applicant.

Mr. David Unterhalter S.C., Miss Kassie Smith and Mr. Ewan West (instructed by Treasury Solicitor) appeared for the Respondent.

## 1. INTRODUCTION

1. The Applicant in this appeal (“Stagecoach”) brings a challenge under section 120(1) of the Enterprise Act 2002 (“the Act”) against the decision published by the Respondent (“the Commission”) on 11 November 2009 entitled “A Report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited” (“the Decision”). The merger of Stagecoach and Preston Bus Limited (“PBL”) was referred to the Commission by the Office of Fair Trading (“OFT”) on 28 May 2009. According to section 35 of the Act, the Commission’s task when a completed merger (as opposed to an anticipated merger) is referred to it is to decide whether a “relevant merger situation” (“RMS”) has been created. If the Commission decides that an RMS has been created, it must then consider whether the creation of that situation has resulted or may be expected to result in a substantial lessening of competition (“SLC”) within any United Kingdom market.
2. In the Decision, the Commission found that an RMS had been created. It went on to decide that the merger had resulted in a SLC in the market for commercial bus services in the Preston area as a whole. This, the Commission found, could be expected to lead to a worsening in the price and non-price factors of competition in that market. Before the merger, the parties had exerted a competitive constraint on each other either directly or as potential competitors. That constraint disappeared as a result of the merger. The Commission concluded that the only effective remedy for that SLC would be a divestiture by Stagecoach of a reconfigured PBL business. The Commission identified a divestment package comprising bus routes, the PBL depot and other assets which Stagecoach should sell within a set period of time. Stagecoach has not applied to this Tribunal for a stay of the Commission’s Decision and at the time of preparing this judgment, Stagecoach is in the process of negotiating the sale of the reconfigured business in accordance with the undertakings it has given to the Commission.
3. Stagecoach’s first ground of challenge asserts that although the Commission started out by treating the completion of the transaction whereby Stagecoach acquired the shares in PBL as the RMS, the reasoning in the Decision subsequently took a wrong turn. As Stagecoach reads the Decision, the Commission did not, as it should have done, go on to consider whether the creation of *that* RMS itself resulted in a SLC. Rather, it broadened its inquiry to consider whether the events which had occurred in the market over the 18

months prior to the acquisition had resulted in an SLC. Stagecoach asserts that because the Commission characterised what had happened over the 18 months leading up to the acquisition as “abnormal competition”, the Commission did not consider, or make any finding on, the question posed by section 35, namely what effect, if any, the RMS had on competition. Instead the Commission compared the position on the market after the merger with the position as it had been in June 2007. This, Stagecoach asserts, is a clear error of law.

4. In the second and third grounds of review, Stagecoach challenges the Commission’s findings of fact in relation to what happened in the 18 months prior to the merger. It argues that the Commission made findings which were not supported by sufficient or any evidence and that the Commission unfairly preferred the evidence of PBL’s witnesses adverse to Stagecoach over the evidence of other witnesses. Finally, in the fourth ground, Stagecoach argues that the remedy proposed by the Commission is disproportionate.

## **2. THE EVENTS LEADING UP TO THE MERGER**

5. The Commission’s analysis of the events leading up to the merger is key to its reasoning in the Decision and to an understanding of the challenges brought by Stagecoach.
6. Stagecoach is an international public transport group with bus and rail operations in the UK and North America. Its largest division is UK Bus which has its headquarters in Perth. It manages 18 geographically distinct operating units, each with its own managing director, operations director and engineering director. One of these is Stagecoach Northwest which is based in Carlisle and responsible for seven depots including the freehold depot in Preston. Stagecoach operates buses in more than 100 towns and cities throughout the United Kingdom.
7. PBL was formed in 1986 to take over Preston Borough Council’s Transport Department. In 1993 the company was sold to its employees, each of whom was allowed to subscribe for shares in a non-trading holding company. Over time, employee ownership has declined and by 2008, about one third of the ordinary shares were directly owned by employees with the remainder having been transferred to an Employee Benefit Trust. PBL operated from a freehold depot in Preston which housed 95 buses and 249 staff.

8. In the Decision, the Commission noted that in general, bus operators considered Preston to be ‘good bus territory’. The existence of a number of housing estates, a high level of business activity and a good mix of socio-economic groups from a bus operator’s perspective were quoted as positive features of the Preston market. The number of bus passenger journeys made in the Preston area (based on Stagecoach’s figures) was 887,500 in the month of May 2007. This increased to 996,600 in May 2008 and, following the merger, decreased to 918,900 in May 2009.
9. Before the events leading up to the merger, PBL’s operations were traditionally focused on serving intra-urban routes in Preston city centre, north of the River Ribble. The Commission described PBL’s network as having been relatively settled over the years. Until June 2007, Stagecoach operated two intra-urban services, both from Preston Bus Station to Penwortham, south of the River Ribble. Stagecoach also operated (and still operates) the vast majority of inter-urban services to and from Preston. At the hearing, Mr Unterhalter SC, appearing for the Commission referred to this situation, whereby PBL mainly provided intra-urban services along routes within Preston city centre and Stagecoach concentrated on providing inter-urban services between Preston and surrounding towns, as an “equilibrium” that had proved fairly stable over a number of years. In the section of the Decision dealing with the definition of the relevant product market (section 7), the Commission concluded that intra and inter-urban services formed part of the same product market rather than two distinct markets because of the scope for supply-side substitution as between Stagecoach and PBL.
10. Stagecoach had, for a number of years, discussed internally the possibility of expanding its Preston business, whether by way of increased direct competition or through the acquisition of PBL. In July 2006, Stagecoach made an approach to buy PBL. That approach was firmly rejected by PBL. Stagecoach then made preparations for the launch of a number of additional intra-urban services in Preston. It ordered 25 new minibuses, recruited new drivers and began the process of developing routes and timetables, applying for the registration of the proposed new services to the Traffic Commissioner. It also made changes to the fare structure and frequency of its existing intra-urban services.
11. In the course of June 2007, both Stagecoach and PBL launched new intra-urban services in Preston in competition with each other. Each company appeared to monitor the

other's service and fare changes closely throughout this period. Stagecoach launched five new services between June and August 2007, marketed as the "Preston Citi" network, adding a further service in October 2007 in response to an expansion by PBL in that part of the city in June 2007. PBL responded to Stagecoach's actions by launching its own services in competition with Stagecoach's established routes to Penwortham and Southport, registering a new service, changing the frequency of certain services and putting ten new vehicles onto its established routes north of the River Ribble.

12. This intense period of competition between the two companies had a number of consequences. Complaints were received by the Traffic Commissioner about traffic congestion and passenger loading problems. The Commissioner imposed a traffic regulation condition from 30 July 2007 and, after further complaints, invited both Stagecoach and PBL to attend a public inquiry. The proposed inquiry did not ultimately take place, as Stagecoach and PBL were able to agree that a certain percentage of their services should be monitored. As noted at paragraph [8] above, there was an increase in overall passenger numbers carried within Preston (by around 12 per cent, comparing May 2007 with May 2008), although the number of passengers travelling on PBL's services declined over the same period from around 790,000 to around 730,000 passengers per month. The number of passengers travelling on Stagecoach's services increased from around 90,000 to around 270,000 passengers per month over this period.
13. The depots operated by Stagecoach and PBL in Preston, which had both been operating at a profit prior to this period, became loss-making. The Commission's analysis of profitability is the subject of some dispute between the parties, but it is common ground that the management of both PBL and Stagecoach were concerned at the losses incurred during this period and began to explore options to make savings. Stagecoach took certain measures to reduce costs in December 2007, including the withdrawal of certain services and the relocation of buses between services. PBL too considered certain proposals for improving efficiency and making savings in March 2008, leading to the withdrawal of two services and the reduction of certain frequencies.
14. In April 2008, PBL sought advice from the consultants KPMG on its strategic options. KPMG reported that in the light of its forecast trading losses, the company was "not viable in its current form" and set out four options: to trade on; to invest; to sell the company; or to liquidate. PBL's directors instructed KPMG to find a trade buyer for the

company. KPMG initially approached seven bus operators (excluding Stagecoach) and preliminary offers were received from two companies, Arriva and Go-Ahead, in July 2008. In the event, neither of those companies was prepared to proceed to purchase and in mid-September 2008, KPMG was instructed by PBL to approach Stagecoach. An indicative offer was made by Stagecoach for the PBL business on 10 October 2008. After further discussions between the parties, a revised offer was submitted on 27 October 2008 and this was accepted. A share purchase agreement was signed by the parties on 23 December 2008 and the acquisition completed on 23 January 2009.

### **3. GROUND 1: ERROR OF LAW IN APPLYING SECTION 35 OF THE ACT**

15. The Commission's analysis of the events between June 2007 and the completion of the merger was set out in section 5 of the Decision. It described the increase in services, the effects of the launch of Stagecoach's new services and PBL's response. For the purposes of Ground 1 it suffices to note the Commission's conclusion at paragraph 5.82 of the Decision namely:

“...Stagecoach's conduct in the two-year period that preceded the merger had the effect of driving PBL out of the market and/or rendering it unattractive to a potential purchaser, conduct that Stagecoach pursued with little regard for profit and normal commercial considerations. The character of Stagecoach's entry into the Preston intra-urban market in the period that led up to the merger situation and its effects on both its own Preston operations and on PBL are relevant in our consideration of the counterfactual, ie what would have happened had the merger not occurred, including whether the effects of the merger should be assessed on the basis that PBL was a 'failing firm' at the time of the merger, as Stagecoach has argued.”

16. What matters for the purposes of Ground 1 is how these conclusions on the facts flowed through into the reasoning when the Commission came to apply the test laid down in section 35 of the Act. That section provides:

#### **35 Questions to be decided in relation to completed mergers**

- (1) .... The Commission shall, ... decide the following questions —
- (a) whether a relevant merger situation has been created; and
  - (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services.
- (2) For the purposes of this Part there is an anti-competitive outcome if —

- (a) a relevant merger situation has been created and the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services; ...

...

(3) The Commission shall, if it has decided ... that there is an anti-competitive outcome (within the meaning given by subsection (2)(a)), decide the following additional questions —

- (a) whether action should be taken by it ... for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted from, or may be expected to result from, the substantial lessening of competition;
- (b) whether it should recommend the taking of action by others for the purposes of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted from, or may be expected to result from, the substantial lessening of competition; and
- (c) in either case, if action should be taken what action should be taken and what is to be remedied, mitigated or prevented.

(4) In deciding the questions mentioned in subsection (3) the Commission shall, in particular, have regard to the need to achieve as comprehensive solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it.”

17. The Commission’s application of this test to the facts of the case was dealt with in section 6 of the Decision, headed “Counterfactual”. Both parties addressed us on the proper role of a counterfactual in the application of section 35. Inherent in the SLC test is the need to draw a comparison between two situations so that one can assess whether the situation which includes the relevant merger exhibits substantially less competition than the comparator. In *British Sky Broadcasting Group plc v Competition Commission & Anor* [2008] CAT 25 (“*BSkyB (CAT)*”) at paragraph [85] the Tribunal described a counterfactual in the following terms:

“The SLC test in the Act requires an assessment of the effects of a merger on the state of competition in a relevant market. In assessing the likely effects of a merger on competition, the Commission, as in the present case, typically compares the situation that may be expected to arise following the merger with that which would have prevailed without the merger (...). The market situation without the merger is often referred to as the “counterfactual”. The counterfactual provides a useful benchmark against which the existence or otherwise of SLC can be judged.”

18. The Tribunal's conclusion on the counterfactual was upheld by the Court of Appeal: [2010] EWCA Civ 2, paragraph [55]. In *BSkyB (CAT)*, the Tribunal went on to say this about the way in which the counterfactual may be identified (paragraph [91]):

“... the purpose of the counterfactual is to assist in assessing the effects of the merger. However, it must be kept in mind that the counterfactual is not a statutory test: it is an analytical tool used to assist in answering the question posed by section 47 of the Act, namely whether the creation of an RMS may be expected to result in an SLC within any market or markets in the United Kingdom for goods or services. Competitive conditions can and do change over time, and it is important to take into account the potential for change in the market in order to consider as fully as possible the level and intensity of competition without the merger.”

19. We were also referred to the Commission's *Guidelines on Merger References* (CC2, June 2003) and the draft joint “Merger Assessment Guidelines” published by the OFT and the Commission which are currently the subject of a public consultation. Both of these describe the purpose of the counterfactual in similar terms.
20. We agree with the Commission's submission that section 35 does not require it, in every case, to compare the situation after the merger has taken place with the situation on the market just before the merger, that is, the situation which would have pertained if Stagecoach and PBL had been unable to agree terms for the transaction but all other factors had remained the same. The correct comparison is between the situation post-merger, and the situation which, on the balance of probabilities, is the situation which *would* have developed in the market in the absence of that merger. It therefore involves a forward looking, hypothetical exercise. In some cases, it will make sense to assume that the situation immediately before the merger would have continued in the absence of the merger so that the predicted future without the merger is in fact a continuation of the actual, pre-merger position. But that will not always be the case. Stagecoach referred to particular instances where it would be legitimate to choose a counterfactual different from the situation immediately preceding the merger, namely where external events are foreseeable which would affect the market or where the pre-merger position is affected by illegal anti-competitive activity. In our judgment, the circumstances in which the Commission can properly decide that the immediate pre-merger situation is not a good prediction of what would have happened in the absence of the merger are not limited to those circumstances.

21. As a final preliminary remark, we note that a number of submissions made by the parties are relevant both to Ground 1 and Ground 2 and that the boundary between the two grounds has at some points been blurred. We have treated Ground 1 as a challenge to how the Commission construed section 35 of the Act as regards the test that it should apply in approaching the question whether the creation of the RMS had resulted in an SLC. Ground 2 by contrast challenges the choice of the counterfactual itself. The points are linked in that Stagecoach asserts that by applying the wrong test, the Commission inevitably arrived at the wrong counterfactual. Some of the arguments that Stagecoach advances in support of Ground 1 have been considered by us in relation to Ground 2 if it appears to us that they are more relevant there.
  
22. With this in mind, we turn to consider how the Commission approached the issue in section 6 of the Decision. The Commission considered the argument put forward by Stagecoach that PBL was “a failing firm” by which it meant that, absent the merger, PBL would have been unable to meet its financial obligations in the near future. The most likely outcome was that PBL would have entered administration and would have been liquidated. Its assets would have been unlikely, Stagecoach argued, to have been acquired to provide local bus services in Preston. If this were the correct counterfactual, then the merger would have had minimal effect on the structure of the market because, either with or without the merger, Stagecoach would have replaced PBL on all the intra-urban routes in Preston.
  
23. The Commission considered this proposed counterfactual in Appendix H to the Decision. The Commission identified correctly that it was not sufficient to consider simply whether or not PBL would have gone into liquidation. It was important to go on to consider whether, if PBL had gone into liquidation, its assets would have exited the market or would inevitably have been taken over by Stagecoach or would have been sold to another operator who would continue bus operations in Preston in competition with Stagecoach. The Commission first addressed the question whether PBL would have become unable to meet its financial obligations absent the merger in January 2009. The Commission looked at evidence such as PBL’s management accounts and a report by KPMG and concluded that “it was likely that PBL would eventually have been unable to meet its financial obligations”.

24. The Commission found that it was unlikely, in the continuing presence of abnormal competition from Stagecoach, that PBL would have been able to restructure itself with external finance. The Commission considered whether it was likely that a buyer other than Stagecoach would have been attracted to buy PBL. The Commission also examined whether a sale of the assets rather than of the business might have been possible, either by a “prepack administration” under which PBL agreed to sell its trading assets (depot, buses, and employees) to fund an agreed settlement of its debts with its creditors or by the sale of assets on its liquidation.

25. In the final paragraph of Appendix H, the Commission said:

“42. ... even if PBL had gone into administration, we cannot be certain that no operator other than Stagecoach would have commenced services on at least some of PBL’s routes, using buses, facilities and staff that they already owned or which they acquired from an insolvent PBL. We are not therefore satisfied that Stagecoach would inevitably have ended up with as high a share of the market for bus services in Preston as it now has as a result of the merger.”

26. Mr Thompson QC on behalf of Stagecoach argued that the Commission had left open the issue whether in the absence of a bid by Stagecoach, PBL would have been acquired by a third party or whether, in the case of an administration, third parties might have commenced services on at least some of PBL’s routes. It is true that Appendix H does not decide in precisely what form PBL’s assets would have continued to operate on the intra-urban routes without the merger. But it is clear from the Decision that the Commission did conclusively reject the failing firm defence. In paragraph 6.2 of the Decision the Commission clearly states, having set out the argument put forward by Stagecoach, that -

“Given the circumstances of this merger described in Section 5, and for the reasons set out in the following paragraphs, we do not consider that this is an appropriate basis for the counterfactual analysis. For completeness, our detailed consideration of Stagecoach’s submission that PBL was a failing firm is set out in detail in Appendix H.”

27. Further at paragraph 6.4 of the Decision the Commission stated that it did not accept that “Stagecoach would inevitably have ended up with its current high share of the market for bus services in Preston irrespective of the merger”.

28. In our judgment, Appendix H sets out a thorough and entirely appropriate assessment of the various options and arrives at the conclusion that it was not inevitable that PBL’s

assets would either leave the market entirely or be taken up by Stagecoach. Appendix H considers the likely future fate of PBL on the basis of the poor financial position it was in as at late 2008. On the basis of that analysis the Commission was entitled to reject the failing firm defence and we find that it did indeed arrive at that conclusion in the Decision.

29. Having rejected Stagecoach’s proposed counterfactual, the Commission then considered what was the appropriate counterfactual to adopt. In an important passage in the Decision the Commission stated:

“6.4 We also, however, consider that in assessing the counterfactual it is appropriate to disregard steps taken by the acquiring company which had the effect of bringing about the merger. As explained in detail in Section 5 (...), we received extensive evidence that Stagecoach’s conduct in the 18 months that preceded the merger was pursued with little regard for profit and normal commercial considerations. This abnormal competition from Stagecoach in our view had the effect (and must have been expected to have the effect) of removing PBL from the market or marginalizing it as a competitive threat to Stagecoach (including by rendering it an unattractive acquisition to third parties). Given the nature of Stagecoach’s behaviour and the significant losses incurred by both companies, *we do not consider that the competition that took place during this period reflects the rivalry that could be expected to occur in the absence of the merger.* Nor, for the same reason, do we accept that we should assess the counterfactual on the basis that PBL was a ‘failing firm’ at the time of the merger and that Stagecoach would inevitably have ended up with its current high share of the market for bus services in Preston irrespective of the merger.

6.5 The appropriate starting point for the assessment of the counterfactual is therefore the period that preceded the launch of Stagecoach’s new services in Preston as representing normal, pre-merger market conditions.

6.6 Starting with the situation that prevailed in Preston until early 2007, *we considered what could have been expected to happen to PBL and Stagecoach’s bus operations in Preston in the absence of a merger between them.*” (emphasis added)

30. The Commission then considered the options faced by PBL and by Stagecoach. It concluded as follows:

“6.13 We therefore concluded that the appropriate benchmark against which to assess the competitive effects of the merger was the competitive situation which prevailed before the launch of new intra-urban services by Stagecoach in 2007. PBL would most likely have continued to operate buses in Preston in much the same way as it had done in preceding years. Stagecoach Preston would also most likely have continued to operate on its old routes while seeking improved profitability in one way or another, whether as part of Stagecoach or in the hands of another operator.”

31. Stagecoach argues that paragraph 6.4, in describing the events following the launch of the new Stagecoach services in June 2007 as “steps taken by the acquiring company

which had the effect of bringing about the merger” and saying that it was appropriate to “disregard” them, shows that the Commission wrongly treated the RMS as including the 18 month period from mid-2007 until the completion of the share acquisition transaction. It argues that this is inconsistent with the statutory framework because an RMS only arises where two enterprises cease to be distinct. That did not occur until the acquisition in January 2009.

32. On a fair reading of the Decision, we do not accept Stagecoach’s submission that the Commission wrongly construed the phrase “RMS” as encompassing the pre-merger period of “abnormal competition”. It is true that some of the wording in the first part of paragraph 6.4 is confusing and we will examine this more closely in the context of Ground 2. But so far as Ground 1 is concerned, in the latter part of that paragraph, the Commission formulates its conclusion as a conclusion as to “what *could have been expected* to happen to PBL and Stagecoach’s bus operations in Preston in the absence of a merger between them” (emphasis added). This indicates that it did address its mind to the correct question.
33. Similarly in paragraph 6.6 the Commission states that it has considered “what *would have been expected to happen* to PBL and Stagecoach’s bus operations in Preston in the absence of a merger between them” (emphasis added). Again that shows that the Commission realised that the exercise it was engaged in was that of trying to predict what the future held for this market in the absence of the merger.
34. The Commission dealt with the identification of the RMS in a different section of the Decision and clearly identified the RMS as the transaction that was completed in January 2009: see paragraphs 3.9 and 3.10 of the Decision. There is no suggestion in section 6 that the Commission is revisiting that definition and seeking to extend it to cover other events.
35. The Commission’s analysis, so far as the legal test in section 35 is concerned, seems to us entirely conventional. The position in the market immediately before the merger was one where there was far more bus capacity operating on the routes than was justified by the volume of passenger traffic and where consequently both parties were making substantial losses. The Commission characterised this situation as one of “abnormal” competition. We agree that it is “abnormal” in the sense that it is unsustainable in the

medium to long term because it involved the commitment of a significant amount of excess capacity to the routes and significant reductions in the fares. As Mr Unterhalter put it in argument before us, the Commission considered that the competition which took place during the 18 month period did not reflect the rivalry that could be expected to occur in the absence of the merger – the features that characterised the conduct over those 18 months did not give a reliable guide to the future: see Transcript of 9 March 2010, page 70. The Commission was therefore fully entitled to find that the level of competition as at the end of 2008 was not sustainable and that even in the absence of the merger, that intensity of competition would not have carried on much longer. It was therefore entitled to conclude that the situation immediately preceding the merger was not the appropriate counterfactual and it was not right to assume that the counterfactual should posit a scenario where Stagecoach had won the whole of PBL’s commercial business and was the sole supplier of bus services in Preston.

36. The Commission went on to conclude that the correct counterfactual was the position of the parties as at June 2007. Whether the counterfactual chosen is sustainable is a question to be considered under Ground 2. But we do not see that in arriving at that conclusion, the Commission fell into the legal errors that Stagecoach has alleged in Ground 1. We therefore find that Ground 1 of Stagecoach’s application for review fails.

#### **4. GROUND 2: WEDNESBURY UNREASONABLENESS**

37. Given the Commission’s conclusions in Appendix H, it was inevitable that it would go on to conclude that the acquisition of PBL by Stagecoach gave rise to an “anti-competitive outcome” within the meaning of section 35(2)(a) of the Act. Once the failing firm defence is rejected, the appropriate counterfactual must be a situation in which more than one company continues to operate on the Preston market. That must mean, comparing the post merger situation with any likely counterfactual, that this is “a merger to monopoly” as the Commission put it.
38. The Commission went on in section 8 of the Decision to examine the theories of harm applicable to the merger. The Commission examined the extent of actual overlap between the parties’ routes and the scale of potential competition as a constraint on both parties’ actions. It also considered the likelihood of market entry by a third party and concluded that the merger had led to an SLC in relation to commercial services. In our

judgment, the Commission's conclusion that this merger resulted in an SLC and hence that it should be prohibited was unassailable.

39. But that is not the end of the matter. The question whether the Commission acted rationally in finding that the correct counterfactual was the pre-June 2007 market pattern, or whether that decision was arrived at without any sufficient factual basis must still be answered. It is relevant as a matter of principle to establish whether Stagecoach's challenge to the rationality of the Commission's conclusion is well founded. But it also still has a practical relevance to this case. The counterfactual is important not only for deciding whether the merger results in an anti-competitive outcome. It is also a key factor in determining the nature and scope of the action that the Commission decides should be taken for the purpose of remedying, mitigating or preventing the SLC concerned, or any adverse effects resulting from it, as discussed in paragraphs [136] onwards below. We therefore turn to Ground 2 of Stagecoach's application.

**(a) The application of judicial review principles by the Tribunal**

40. In section 6 of the Decision, the Commission concluded that in the absence of the merger "PBL would most likely have continued to operate buses in Preston in much the same way as it had done in preceding years. Stagecoach Preston would also most likely have continued to operate on its old routes whilst improving profitability in one way or another." By Ground 2 of its application, Stagecoach invites the Tribunal to find the Commission's choice of counterfactual as being the pattern of business that the parties had shared before June 2007 was irrational in that it had no foundation on the evidence before the Commission.
41. Section 120(4) of the Act provides that in determining an application to review a merger decision, the Tribunal "shall apply the same principles as would be applied by a court on an application for judicial review". The intensity of the review that the Tribunal undertakes in this context has been considered recently by the Court of Appeal in *BSkyB v Competition Commission* [2010] EWCA Civ 2 ("*BSkyB (CA)*"). The applicant in that case had argued that the Tribunal is obliged to apply judicial review principles with a greater intensity of review because it is a specialist judicial body. The Tribunal had rejected this argument and the Court of Appeal rejected it also. Having cited the observations of Carnwath LJ in *Office of Fair Trading v IBA Health Ltd* [2004] EWCA

Civ 142 about the flexibility of the judicial review test, the Court of Appeal went on to say (*BSkyB (CA)* paragraph [37]):

“.. the Tribunal is to apply the normal principles of judicial review, in dealing with a question which is no different from that which would face a court dealing with the same subject-matter. It will apply its own specialised knowledge and experience, which enables it to perform its task with better understanding and more efficiently. The possession of that knowledge and experience does not in any way alter the nature of the task.”

**(b) The relevant judicial review principles in this case**

42. As to the judicial review principles that apply to a challenge of the factual basis of the decision, Stagecoach referred to the formulation of the relevant question in *UniChem v Office of Fair Trading* [2005] CAT 8, paragraph [174]. According to that case, the Tribunal must determine whether the Commission’s conclusions are adequately supported by the evidence, whether the facts are properly found and whether all material considerations are taken into account. Stagecoach accepted that it is not the Tribunal’s task to reassess the relative weight of different factors arising from the evidence before the Commission. The task is to assess whether the Commission had an adequate evidential foundation for arriving at the factual conclusions that it did, in the sense that, on the basis of the evidence before it, it could reasonably have come to those conclusions.

43. The Commission referred us to the passage in *BSkyB (CAT)* at paragraph [54] where the Tribunal quoted from a leading text book *Administrative Law* (9th edition) edited by Sir William Wade and Christopher Forsyth (at pages 272 and 273):

“... It is one thing to weigh conflicting evidence which might justify a conclusion either way, or to evaluate evidence wrongly. It is another thing altogether to make insupportable findings. This is an abuse of power and may cause grave injustice. At this point, therefore, the court is disposed to intervene.

‘No evidence’ does not mean only a total dearth of evidence. It extends to any case where the evidence, taken as a whole, is not reasonably capable of supporting the finding; or where, in other words, no tribunal could reasonably reach that conclusion on the evidence. This ‘no evidence’ principle clearly has something in common with the principle that perverse or unreasonable action is unauthorised and ultra vires.”  
(footnotes omitted)

44. That passage also appears in the more recent edition of Wade & Forsyth: pages 229 to 230.

45. We accept the Commission’s analysis of the case law on this point and we agree that the hurdle that Stagecoach has to overcome in order to make good its challenge under Ground 2 is a high one. Where Stagecoach asserts that there is no or no sufficient evidence to support one of the Commission’s key findings, Stagecoach must show either that there is simply no evidence at all to support the Commission’s conclusions or that on the basis of the evidence the Commission could not reasonably have come to the conclusions that it did. The fact that the evidence might have supported alternative conclusions, whether or not more favourable to Stagecoach, is not determinative of unreasonableness in respect of the conclusion actually reached by the Commission. We must be wary of a challenge which is “in reality an attempt to pursue a challenge to the merits of the Decision under the guise of a judicial review”, which is how the Commission characterised Stagecoach’s Ground 2.

46. The Commission also reminded us that it is important to consider the evidence relied on in the Decision “taken as a whole” and that the Decision should not be analysed as if it were a statute. The Tribunal must consider the materiality of any “fact” found by the Commission which the Tribunal determines has no evidential foundation – not every failure in fact-finding and analysis by a decision making body requires or permits its finding or decision to be quashed.

47. Finally we have in mind what the Tribunal said recently in *Tesco v Competition Commission* [2009] CAT 6:

“The grounds of judicial review are well-established. They frequently overlap with each other. It is not uncommon for a particular flaw in a decision or a decision making process to fall within more than one ground. Failure of a decision-maker properly to take account of a relevant consideration in reaching its decision is among the grounds most frequently relied upon in judicial review. It is sometimes considered under the broad label of irrationality, but is also (and perhaps more appropriately in the present case) treated in its own right as a ground of challenge to the validity of a decision. This ground, and its converse ground of taking account of an irrelevant consideration, clearly reflect the fact that judicial review is in general about legality and the decision-making process rather than the merits of a decision.”

48. It is important to get to the kernel of Stagecoach’s assertion that the Commission’s findings were irrational and beyond the bounds of what the Commission could reasonably have found by considering its legality and the decision-making process, as disclosed in the Decision. The question we must ask ourselves, paraphrasing the description of the *Wednesbury* test expressed by the Vice Chancellor (as he then was) in

*Office of Fair Trading v IBA Health Ltd* [2004] EWCA Civ 142, is whether the Decision is so unreasonable as to be a decision which no Commission properly instructed and taking account of all, but only, relevant considerations could arrive at.

**(c) The Commission's counterfactual**

49. We take up our analysis of the Commission's reasoning on the counterfactual at the point where, at the end of Appendix H, the Commission rejects the failing firm defence. In paragraph 4 and 5 of that Appendix the Commission says:

“4. By September 2008, PBL had received bids from Arriva and Go-Ahead. Arriva had requested further information on liabilities including the pension scheme. PBL was also negotiating with PCC over the pension scheme deficit and the Council's guarantee.

5. At this point it was decided to approach Stagecoach, and in mid-September KPMG invited Stagecoach to submit a bid for PBL. Stagecoach responded positively, submitting a preliminary offer on 10 October, commencing the process that led to the merger. We have to consider whether, in the absence of this bid or any later bid from Stagecoach, PBL would have met the criteria for a failing firm set out above.”

50. The Commission there is clearly looking at the situation that existed as at September 2008 when PBL had been severely, if not fatally, damaged by Stagecoach's entry onto the intra-urban routes. Appendix H considers what would have happened from that point on if the merger had not taken place. The Commission concludes (paragraph 40 of Appendix H) that the abnormal or unsustainable level of competition would not have continued and, as we have already found (see paragraphs [20] and [35] above), the Commission was entitled to make that assumption and not to base the counterfactual on the continuing levels of service that existed towards the end of 2008. The Commission concluded that the PBL assets would have continued to operate on the market and would not inevitably have been swallowed up by Stagecoach.

51. We would have expected to see the remainder of the discussion of the counterfactual in section 6 focussing on what was likely to happen after the point that is reached at the end of Appendix H. Thus, one would expect to see the Commission exploring how the market was likely to develop if, as at the end of 2008:

(a) the merger with Stagecoach does not take place;

(b) at least some of PBL assets remain on the market so that Stagecoach is not left as the monopoly provider; and

(c) the period of unsustainable levels of capacity and low prices rapidly comes to an end.

52. In the context of these judicial review proceedings, it is not for the Tribunal to explore those different possibilities or to indicate which might have been the most or least plausible outcome. If that had been the exercise that the Commission had carried out in the remainder of section 6 of the Decision, then the Tribunal would have been very slow to interfere with a decision as to the appropriate counterfactual.

53. But that is not what the Commission has done. The paragraphs in section 6 following the rejection of the failing firm defence do not consider the situation as at September 2008. Rather, as already quoted, paragraph 6.4 states that the Commission disregards what happened in the 18 months prior to the merger because those events are treated as “steps taken by the acquiring company which had the effect of bringing about the merger”. Paragraphs 6.5 and 6.6 then state that “the appropriate starting point” for the assessment of the counterfactual is the period preceding the launch of Stagecoach’s new services in Preston. Paragraphs 6.7 to 6.12 examine the likely financial position of the two parties if Stagecoach’s entry onto the market had not taken place at all in June 2007. The Commission concludes, unsurprisingly, that both parties would have continued in a reasonably healthy financial state. The Commission says that the pre-June 2007 equilibrium was stable and notes that Mr Warneford had confirmed his view that, if PBL had had more efficient management “the two separate businesses could have continued almost indefinitely as they had done before the period of abnormal competition” (paragraph 6.12).

54. There is therefore a striking disconnect between the analysis of the failing firm defence in Appendix H (which is based on the situation which in fact existed in September 2008 following the launch of the Stagecoach services) and the remainder of the analysis of the counterfactual in section 6 (which is based on the assumption that PBL’s business was not damaged because Stagecoach did not expand onto the intra-urban routes). We must therefore examine why the Commission considered it appropriate, in paragraphs 6.4 onwards, to assess the counterfactual on the assumption not just that the period of

abnormal competition came to an end in late 2008 or early 2009 but as if it had never occurred at all.

**(d) Why did the Commission disregard the events of June 2007 – September 2008?**

55. Having considered the Decision and the submissions of the parties before us, we have identified four possible explanations for this approach:

(a) The first is that because of the scope and nature of Stagecoach’s conduct over those 18 months, and/or because the effect of that conduct was to bring about the situation in which PBL was obliged to accept Stagecoach’s offer to purchase its business, that conduct falls to be disregarded as a matter of principle when analysing the counterfactual.

(b) The second possible explanation is that the Commission regarded the period of competition as “abnormal” not just in the sense of unsustainable but also in some pejorative sense so that it was appropriate to disregard it.

(c) The third possible explanation is the Commission’s conclusion that Stagecoach’s conduct in the 18 months that preceded the merger was pursued with “little regard for profit and normal commercial considerations”, a phrase that occurs in both paragraphs 5.82 and paragraph 6.4 of the Decision.

(d) The final possible explanation is the Commission’s rejection of Stagecoach’s evidence that its aim in launching its new services in June 2007 was to improve the profitability of the Preston depot by running 25 or so more buses from that depot.

*(i) Why is the characterisation of Stagecoach’s conduct prior to the merger relevant to the choice of counterfactual?*

56. Much of sections 5 and 6 of the Decision and some of the Appendices are taken up with an analysis of Stagecoach’s conduct over the 18 months prior to the merger. The Commission arrived at certain conclusions about the events of June 2007 to September 2008, for example the commercial strategy behind Stagecoach’s expansion plans and the extent of the losses incurred by Stagecoach on its new routes. Before examining

Stagecoach's assertion that these findings lacked any evidential basis, it is important to consider why they are relevant to the counterfactual. Even if, for example, the Commission has established as a fact that Stagecoach's conduct was pursued "with little regard for profit and normal commercial considerations", why would this justify disregarding that conduct when considering the proper starting point for the counterfactual?

57. Paragraph 6.4 simply asserts that "it is appropriate to disregard steps taken by the acquiring company which had the effect of bringing about the merger". There are a number of points to make about this assertion.

58. First, the reasoning here again appears to be inconsistent with the reasoning in Appendix H. If it had adopted such a principle in Appendix H, the Commission would have found that since PBL's financial crisis had been precipitated by Stagecoach's conduct, the failing firm defence should be dismissed for that reason. Instead, as we have described, the Commission undertook a careful examination of what was likely to happen to PBL in the position it actually was in as at September 2008.

59. Secondly, the Commission expressly held back from finding that Stagecoach's intention in launching its services in June 2007 was to remove PBL from the market or marginalise it as a competitive threat. At paragraph 5.81 of the Decision the Commission states:

"5.81 Stagecoach repeatedly denied that its entry to the market was part of any acquisition strategy. Much of the evidence we have seen would be consistent with an objective of driving PBL out the market; but other evidence may suggest otherwise, and objectives may indeed change over time. However, *we do not need to conclude on Stagecoach's intentions* and they are not critical to our analysis given that we are satisfied that the effect of its actions during the period of abnormal competition was to drive PBL out of the market. Stagecoach's entry into PBL's routes caused considerable damage to PBL's profitability and ultimately resulted in its owners' decision to sell. ...". (emphasis added)

60. The Commission has also recognised that there was nothing illegal in Stagecoach's actions in or after June 2007. However, the Commission appears in paragraph 6.4 to be asserting that because that conduct was not "normal"; because it had the effect of marginalising PBL as a competitor and because it inevitably led to PBL accepting Stagecoach's offer to buy its business, that conduct should or could be disregarded when considering the counterfactual. In other words, the Commission appears to say that where the pre-merger conduct of the acquiring company is instrumental in bringing about

the merger, then even though that conduct was not pursued with that intention and even though it was not illegal, that conduct can or should be disregarded when considering the counterfactual – at least if the conduct is not based on “normal commercial considerations”.

61. Stagecoach described this approach as “unprecedented” and we agree that it is a novel and potentially wide-ranging principle. It is unclear to us, from that fleeting reference in paragraph 6.4, whether the Commission was in fact asserting this as a reason for adopting the counterfactual or not. The opening words of paragraph 6.4 acknowledge that the Guidance which is quoted in paragraph 6.3 does not contemplate this as a factor which is relevant in choosing a counterfactual. There are no precedents for such an approach cited in the Decision. At the hearing before us this argument was not the focus of the Commission’s submissions and we were not taken to any domestic or European authorities in which such an approach has been considered or adopted. There has been no discussion, either in the Decision or in argument before us, of where the bounds of such a principle might lie.

62. For all those reasons it would not be right for us to explore whether, if such a principle has been relied on by the Commission, that would in itself constitute a serious flaw in the Decision. For present purposes we consider that if it was the Commission’s intention to establish this new principle in this case, there should have been much clearer and more consistent reasoning to support it. The lack of clarity in the Decision about why and in what way the Commission took into account the various factual matters analysed at length in the Decision when arriving at its choice of the counterfactual is relevant to our overall consideration of the rationality of that choice.

*(ii) Was Stagecoach’s conduct “abnormal” in a pejorative sense?*

63. Stagecoach submitted that the Commission decided to disregard what happened in the market from June 2007 onwards because they disapproved of that conduct for some reason: see paragraph 64 of the Notice of Application. Stagecoach argued that the phrase “abnormal competition” used at various points in the Decision has no clear or recognised meaning in competition law and that the Commission does not explain how Stagecoach’s conduct differs in this situation with intense competition on the merits. Stagecoach also points to the fact that if the Commission relies on the long duration of the losses incurred on the intra-urban routes, it should have recognised that Stagecoach’s conduct was not

“abnormal” at the outset but only became so at some later stage. This would not therefore support ignoring Stagecoach’s initial entry onto the intra-urban routes when formulating the counterfactual.

64. The Commission fully accepted that there was nothing illegal in what Stagecoach did. Stagecoach was not dominant in the market as defined by the Commission in the Decision. The Commission denied that there was any pejorative connotation to the characterisation of Stagecoach’s conduct as “abnormal”. It was not trying, as Stagecoach alleged, to introduce some quasi-Competition Act 1998 control mechanism over the competitive conduct of a non-dominant company.
65. We agree that it would have been wrong for the Commission to choose to disregard the 18 months pre-merger conduct if the basis of that choice was that Stagecoach’s conduct over those 18 months was undesirable or reprehensible in some way. Stagecoach was under no obligation to maintain the “equilibrium” whereby it concentrated on inter-urban routes and PBL concentrated on intra-urban routes. There was nothing inherent in the fact of Stagecoach’s decision to attack PBL’s routes that would provide any basis for the Commission treating June 2007 as the starting point for the counterfactual rather than the position which would have pertained in late 2008/early 2009.

*(iii) Stagecoach’s alleged lack of regard for profit and normal commercial considerations*

66. The third possible reason why the Commission disregarded Stagecoach’s conduct over the 18 months prior to the merger was because, according to paragraph 6.4 of the Decision, the Commission had received extensive evidence that that conduct “was pursued with little regard for profit and normal commercial considerations”. Stagecoach argues that there was no factual basis for this finding. So far as the challenge to the factual underpinning of the conclusion stated in paragraph 6.4 is concerned, there appear to be two main reasons supporting this conclusion. The first reason was the lack of contemporaneous documents showing the financial justification on which Stagecoach’s decision to launch the services had been based. This lack of documentation was also a material consideration for the Commission in its assessment of Stagecoach’s ultimate objectives in pursuing this strategy, see paragraph [114] below. The second reason was the scale and duration of the losses incurred by Stagecoach on the new routes.

(a) Absence of contemporaneous documents concerning strategy and forecasts

67. In paragraph 5.12 of the Decision the Commission lists 15 observations derived from its examination of all the evidence. Three of these contain comments about the lack of financial documents:

“(d) Two weeks after the meeting, Stagecoach produced what was referred to as a ‘business plan’ for new services in Preston, which included high-level cost estimates but for which no revenue estimates were made and no strategic rationale was set out (as detailed in Appendix F, paragraph 22).

....

(f) A £[ . ] million investment in new buses and the recruitment of 57 staff were carried out, apparently without any financial appraisal or documented plan.

...

(i) Although the new services were allocated a code name (‘Project Biscuit’), we saw no internal document setting out Stagecoach’s aims and objectives in Preston or revenue expectations.”

68. Appendix F refers to repeated requests for information made to Stagecoach during the course of the investigation and the issue of a formal notice under section 109 of the Act asking for all emails received or sent over a three year period by five individuals containing one of a number of key words. The Commission records that the vast majority of material forthcoming was not relevant and that:

“There was no plan, strategy or formal document on which we could rely to establish Stagecoach’s strategic intentions in Preston. We were told that Stagecoach proceeded with the investment of £4 million in new vehicles and the recruitment of 70 staff, including 55 drivers, without any documented plan.”

69. The Appendix records further requests for costs and revenue projections and that although a spreadsheet of the budget for 2007/08 was eventually disclosed the Stagecoach director who had direct responsibility for the performance of the Preston depot “appeared unaware of these cost and revenue projections when questioned during the inquiry.” This suggested to the Commission that “the future performance of the new intra-urban Preston services was of little concern to any of Stagecoach’s directors when the decision was made to launch them”.

70. Although the Commission denied drawing any inferences from the absence of Stagecoach documents, the Decision clearly shows that the Commission did rely on this as part of the justification for concluding that Stagecoach’s directors were not concerned

with whether the new services were going to be profitable or not. The question for us is whether the Commission acted rationally in so relying.

71. We start from the proposition that Stagecoach's description of its strategy vis a vis PBL in 2006 and the first half of 2007 was based on facts which were not in dispute. Stagecoach's Preston depot was underused as at June 2007; it could and for a while did accommodate about 25 new minibuses working in and around Preston without any apparent difficulty in terms of overcrowding at the depot. The depot was marginally profitable but its continued existence was important not just for supporting the Preston business but also other parts of the Stagecoach business in the region: see paragraph 2.5 of the Decision. Although limited growth in passenger numbers was likely to result from the launch of the new services, these 25 buses would inevitably take business away from PBL's existing services. PBL was not likely to cede market share without a fight, but Stagecoach had assessed it as "extremely inefficient, unimaginative, rather dull and lacklustre".<sup>1</sup> Stagecoach said it was confident that after that fight, PBL would be forced to retrench from the routes leaving Stagecoach with enough business to enable those 25 new buses to make a contribution to the profitability of the Preston depot.
72. During the course of the Commission's inquiry into this merger, Stagecoach was called to an oral hearing on 17 July 2009 ("the July 2009 hearing"). At that hearing evidence was given by Mr Warneford, the Managing Director of Stagecoach UK Bus since 2000. He explained the rationale behind the expansion in June 2007. He referred to Stagecoach's offer to buy PBL in June 2006 which, as he had expected, had been rebuffed. Mr Warneford said that he then asked his colleague "to do me some rough and ready figures of what would establish a reasonable presence". He referred to placing the order for 25 buses which were not at that point committed to Preston as they could have been reallocated to many other places if Stagecoach had decided not to go ahead with the Preston expansion.
73. Later in his evidence, Mr Warneford was pressed by the Commission members about what calculations were made about projected costs and revenues for the extra buses. In summary, Mr Warneford's evidence (pages 38 to 43 of the transcript) was that given his background and long experience in the bus industry, he and his boss had well in mind that if a minibus of the kind proposed can be established on a route, it will generate, "at

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<sup>1</sup> See Appendix F paragraph 9.

worst” an operating profit of roughly £ [...] a year for the expected 10-year life of the bus and that they would be able to make that profit in the long term. In their view, it was therefore worth attempting to launch these buses in Preston given their assessment that they were likely to win business from PBL. If the buses failed to establish themselves on the route, they could be redeployed on other routes elsewhere in the country.

74. Mr Warneford’s evidence was that he and his boss were able to take decisions about deploying 25 minibuses (in the context of a 7,200 vehicle business) without the need to produce revenue forecasts and net present value revenue calculations. They both know roughly how much profit a minibus makes on a route over the life of that bus. The great uncertainty in the Preston expansion was how hard and for how long PBL would resist ceding business – an uncertainty that made any forecasting of maximum or minimum shorter term revenue rather pointless.

75. In our judgment, there was nothing in Mr Warneford’s explanation that was surprising or suspicious. We agree with Stagecoach that the lack of records does not, given the way that the management of Stagecoach conducts its business in this market, provide any support for a finding that Stagecoach’s directors seemed unconcerned about whether the routes would be profitable or not.

(b) Losses incurred on the new Stagecoach routes

76. An important part of the Commission’s finding that the routes were not operated by Stagecoach on the basis of normal commercial considerations was the apparent contradiction between Stagecoach’s assertion that they had put the new buses into operation in order to increase the profitability of the Preston depot, and the fact that Stagecoach incurred substantial losses on those routes from the date of their launch until the merger with PBL.

77. The Decision records the fact that Stagecoach’s Preston depot generated an operating margin of [...] per cent from £ [...] of revenue in 2007. The Commission then records that the profitability of the depot worsened significantly from June 2007 and that it made an operating loss in both 2008 and 2009. The new services which were introduced by Stagecoach in summer 2007 made substantial losses. In its conclusions at the end of section 5 dealing with the events leading up to the merger, the Commission said:

“5.78 In order to achieve its aims, Stagecoach seemed prepared to suffer heavy losses for a considerable period of time by industry standards (see Appendix G, Annex 3). Although it had taken some action to reduce the scale of those losses, including withdrawal of one service and some fare increases, by the time of the merger, about 18 months after their launch, its new intra-urban services were still generally not covering their incremental costs and there could not have been any reasonable expectation that these services would generate a significant positive return in the near future, absent a radical change to the competitive situation in Preston.

5.79 [...], it seemed to us that the outcome of the abnormal competition in Preston was governed primarily by the scale of losses both protagonists were prepared and able to support, given the level of financial resources available to them and, critically to the eventual outcome, the period for which each was able to do so.”

78. Appendix G set out details of how the Commission had assessed the profitability of the routes. Three different profitability benchmarks were adopted. In each case the Commission expressed the financial results in terms of the industry practice of dividing the year into 13 four-weekly periods starting at the start of the financial year so that for Stagecoach, P1 is the first four weeks following 30 April and P9 is the end of the calendar year.

79. The first measure of profitability used was incremental cost, that is the extra costs actually incurred above existing levels in operating the new routes, such as drivers’ costs, fuel, bus depreciation, tyres, maintenance and an allocation of operations management, administration costs and specific marketing costs. This measure did not include any allocation of depot or head office costs since these costs were not increased by reason of the new buses. The second measure of profitability was allocated direct costs of the new routes, calculated on the standard basis used within Stagecoach for estimating route profitability. The third measure used by the Commission calculated total allocated costs including all overheads and arrived at the following figures.

80. The figures arrived at were as follows:

		P3 – P13 2007/08	P1 – P9 of 2008/09
(1) Incremental Cost Basis	Revenue	[...][C]	[...][C]
	Contribution/(loss)	[...][C]	[...][C]

(2) Allocated revenue Basis	Revenue	[...][C]	[...][C]
	Contribution/(loss)	[...][C]	[...][C]
(3) Total allocated contribution	Revenue	[...][C]	[...][C]
	Contribution/(loss)	[...][C]	[...][C]

81. As regards the incremental costs basis figures, the Commission acknowledges that the incremental contribution approached the break even point from September 2008 onwards. Stagecoach argued that it appears from the figures that the trend was a positive one and the contribution was heading in the right direction. Further it submitted that a price rise was planned and that it could afford to raise prices because its prices were still below PBL's. A small increase in passenger numbers would have made the network consistently profitable on an ongoing basis. The Commission however, commented that the incremental costs were bound to increase "in the long run" and that, in any event, any improvement to the profitability of the Preston depot would have required a contribution in excess of incremental costs.
82. As regards the figures arrived at on the second basis, the Commission noted that the new routes were loss making in each four-week period until the acquisition of PBL. The Commission then assumed in Stagecoach's favour that it would be able to continue to increase its fares in the future without losing passengers and calculated that it would take a further 15 four-week periods for the new routes to start covering their allocated direct costs. If that was right, then the routes would have taken a total of 33 four-week periods to cover their direct allocated costs.
83. Stagecoach did not contest the appropriateness of the benchmarks used or the numbers arrived at. But it strongly contested the inferences that the Commission sought to draw from the figures. Stagecoach was entirely candid with the Commission in stating what should have been obvious - that a move to profitability for these routes on all bases of measurement, and hence any improvement in the profitability of the Preston depot, depended on PBL cutting back its services and ceding passengers and revenue to the new Stagecoach buses. The Commission's assessment of the scale of the losses and its

estimate of how long it would take the routes to be profitable were based on the assumption that both PBL and Stagecoach would over the long run continue to operate the same number of buses on the routes. This, as Stagecoach pointed out to the Commission, was a false assumption because it was clear to both parties that the combined level of bus capacity provided on these routes could not be sustained without them both continuing to suffer heavy losses.

84. In the Decision the Commission does not seem to have grappled with this important point, namely that Stagecoach's commercial justification for expanding onto these routes rested on an expectation that PBL would be forced to reduce its capacity, allowing passenger numbers to increase significantly on the Stagecoach buses. Stagecoach acknowledged that its expectation that PBL would be the one to "blink first" and reduce its service was based on the fact that, as all players in the market knew, Stagecoach's pockets were much deeper than PBL's and could sustain losses more comfortably than PBL.

85. It is not suggested by the Commission that this expectation on Stagecoach's part was unreasonable. On the contrary, as we have described in relation to Ground 1, Appendix H approaches the counterfactual on the assumption that the period of intense, unsustainable competition would come to an end in the short term and that PBL's business would not exit the market entirely. We do not see how it can be rational to make that assumption when considering the failing firm defence in Appendix H and yet base profit forecasts on the continuation of an unsustainable level of competition in Appendix G.

86. In paragraph 5.61 of the Decision the Commission states that:

"We recognized that there would have been a number of possible reactions to the launch of Stagecoach's new services open to PBL's management at the time. It might, for example, have deregistered services or held steady rather than invest. We did not think it was possible to establish with any degree of certainty what other outcomes might have resulted from different strategic decisions by PBL and subsequent behaviour of Stagecoach, given the number of variables that would need to be considered and lack of factual evidence to assist us in making such an assessment."

87. The Commission thus accepted that Stagecoach could have predicted a number of possible scenarios as to how PBL would react, including that it could have deregistered

services. But the Commission concluded that it was not possible to calculate how other reactions would have affected the profitability of Stagecoach's new services. Thus, the calculations in Appendix G do not tell us anything about what would have happened if PBL had reduced capacity to the extent necessary to enable normal and sustainable competitive conditions to be re-established, with Stagecoach competing on the intra-urban routes either with a reduced PBL or a successor to PBL. We agree that any such calculation may well be difficult because of the number of variables and lack of factual evidence. But that does not justify drawing inferences based entirely on the figures arrived at on the basis of how PBL did in fact react, given Stagecoach's consistent assertion that it had expected PBL to cut back its capacity on the routes now facing competition.

88. The parties disagreed over the question whether PBL's reaction in summer 2007 whereby it increased the amount of capacity on its routes was reasonable or not. That is, in our judgment, beside the point if one is considering the commercial considerations underpinning Stagecoach's behaviour. The relevant point was that PBL's reaction was not inevitable, at least as far as Stagecoach was concerned. That being the case, the Commission should not have assessed whether Stagecoach's conduct lacked regard for normal commercial considerations on the basis of the figures arising from that PBL reaction. Even if that reaction was itself within the range of reasonable reactions, it was not the reaction that Stagecoach was expecting and so not the basis on which Stagecoach's plans had been undertaken.
89. There is also no discussion in the Decision as to how far PBL would have had to retrench in order to accommodate Stagecoach's 25 buses and what effect that level of retrenchment would have had on the viability of PBL's business – either as operated by PBL or by a stronger successor undertaking. Paragraph 5.30 refers to the significant cutting back of capacity that Stagecoach undertook on the intra-urban routes *after* the merger. The Commission relies on this to suggest that, contrary to Stagecoach's assertions:

“only a very substantial withdrawal of PBL or Stagecoach from Preston's intra-urban services would have allowed a significant improvement in the profitability of Stagecoach's intra-urban services, let alone Stagecoach's Preston depot, absent the merger.”

90. We do not see, however, how the Commission could reasonably have inferred, from the way in which Stagecoach has behaved once it has become the monopoly supplier in the market, how Stagecoach was likely to have behaved if PBL had retrenched to some smaller degree and the two companies had continued to operate as a competitive constraint upon each other. The finding of an SLC resulting from the merger assumes that the behaviour of a monopolist is *not* the same as the behaviour of the same company acting in a competitive environment. Stagecoach's post merger conduct is not a relevant factor for the Commission to have taken into account when deciding what degree of retrenchment would be needed in a competitive environment to enable both operators' services to operate profitably.
91. At footnote 33 of the Decision, to which Stagecoach drew our attention, the Commission stated that PBL could have accommodated Stagecoach's entry if Stagecoach only took a minority share of the Preston market but could not afford to withdraw significantly from its existing services without destabilising its business. Yet there is no discussion in Appendix H whether Stagecoach's services would have been profitable if that limited accommodation had been made, leaving PBL or a lower cost, stronger successor with a smaller but still viable share of the intra-urban business. That was an important point which the Commission did not investigate and so did not take into account.
92. To summarise our findings on this point, Stagecoach's case was that when it launched the new buses it expected that PBL would cut back its services so that conditions on the market could return to normal. That was the commercial consideration underlying its plan and the Commission has not found that such an expectation was unreasonable. The broad brush figures provided by Mr Warneford at the July 2009 hearing (see paragraph [71] above) provide some indication of the likely scale and duration of the profits the company expected. When compared with the initial losses set out in Appendix G they appear to be consistent with an expectation that an attempt to gain sufficient market share would be commercially justifiable. An analysis of the losses incurred by Stagecoach when PBL reacted in a different, even if reasonable, way provides no evidence to support a conclusion that Stagecoach's plans were undertaken with no regard for the performance of the routes or normal commercial considerations.
- (c) Whether Stagecoach tolerated losses for longer than was normal in the industry

93. Whatever Stagecoach’s expectations may have been when it launched its services, it must have become apparent fairly soon that PBL was determined to fight longer and harder than expected. We agree that when assessing the likely commercial considerations underlying Stagecoach’s plans over the 18 month period, it is important to consider why Stagecoach did not cut back its services once it realised that was the case. In fact Stagecoach did cut back one service on Route 32 some six months after it had been launched. But according to the Commission, Stagecoach persisted in running loss-making buses for “considerably longer than even the longest estimate of the time that other bus operators told us they would require to achieve an overall profitability, let alone cover their direct costs” (see paragraph 41 of Appendix G).
94. The question of how long a bus operator would “normally” be prepared to sustain losses on a new route before withdrawing the service was dealt with in Annex 3 to Appendix G. That Annex referred to four different bus operators whose views the Commission had sought as to how quickly they would expect a new route to cover its costs. The responses (with redactions for confidential information) were summarised as follows:
- “7. Veolia noted in its response to the CC’s questionnaire that [ ].
  - 8. In subsequent correspondence Veolia confirmed that it would [ ].
  - 9. Go-Ahead told us that it did not expect new routes to be profitable straight away but looked to cover direct costs ‘quite soon’. At the hearing with the CC it confirmed that it would expect direct costs to be covered within three to six months.
  - 10. Review of the Transdev response showed that it ‘would seek any new route to be profitable within [...] of operation, depending on the quantum of the initial losses’ but TransDev did not indicate how it would measure profitability.
  - 11. Arriva told us that as regards route profitability, it hoped that direct costs would be covered right from the start. It reviewed costs every three months. It would look for a contribution to overheads as well; its general rule of thumb was that investments made had to cover its weighted average cost of capital (WACC).
  - 12. Finally, we note that small operators told us that they would expect to cover their costs immediately after their entry on a new route.”
95. Shortly before the hearing before the Tribunal in March 2010, the external advisers of Stagecoach were provided, within the confines of a confidentiality ring, with unredacted transcripts of the evidence given by Go-Ahead and Transdev at their respective oral hearings with the Commission.

96. One of the questions that the Commission asked third party bus operators in the written questionnaire sent out before the oral hearings was:

“16. When you decide to enter a new route or introduce a new service, would you expect it to be profitable straight away? If not, what losses would you be prepared to tolerate and for how long before making a decision to continue or to withdraw these services?”

97. The answer given by Go-Ahead in its initial written submission was that it would not expect a route to be profitable straightaway but would look “to cover direct costs quite soon”. The written submission went on:

“The decision on how long to continue would depend on strategic importance, market issues and so on. [...] [C].”

98. Go-Ahead attended an oral hearing at the Commission on 2 July 2009. We have read the four pages of evidence on this topic. [...] [C].

99. Turning to Transdev, they were sent the same questionnaire as Go-Ahead and answered question 16 as follows:

“We would seek any new route to be profitable within [...] [C] of operation [...] [C].”

100. At their oral hearing on 24 July 2009 Transdev’s Chief Executive Officer was asked about this response. [...] [C].

[...] [C].”

101. [...] [C]. His response was, in our judgment, significant in the present context:

[...] [C].”

102. Later at the same hearing the Commission referred the witnesses again to the [...] [C] timeframe Transdev had mentioned in their written response and asked if that depended on whether there was a competitor on the route. [...] [C].

103. We consider that Mr Stevens’ evidence was an important expansion of the short written answer quoted in Annex 3 [...] [C]. Clearly Stagecoach’s routes were strategic rather than opportunistic, and, according to the figures in Appendix G, the incremental revenues and costs were “going in the right direction”.

104. We accept that the paragraphs in Annex 3 were put back to Go-Ahead and Transdev and that they did not object to their accuracy. But that cannot improve upon the evidence that was in fact given in response to the questionnaire and at the oral hearings. There is nothing in what Go-Ahead or Transdev said that supports the Commission's conclusion in paragraph 5.78 of the Decision that Stagecoach's losses lasted "a considerable period of time by industry standards" or that a period of two and a half years before allocated direct costs was covered on the new routes was "considerably longer than even the longest estimate of time that other bus operators told us they would require to achieve an overall profitability, let alone cover their direct costs" (see paragraph 41 of Appendix G). What they said accorded with what Mr Warneford said at the July 2009 hearing. He described the figures on the routes as loss making but "constantly improving". The losses were not fixed but declining every period. He did not feel that the routes had yet reached the point where he had to question very seriously whether the routes were "going to fly".

105. We should record that we have not seen the Veolia or Arriva evidence that is referred to in Annex 3 to Appendix G and the Commission has not sought to rely on it following the challenge to the evidence of Transdev and Go-Ahead.

(d) Conclusion on Stagecoach's alleged lack of regard for profit and normal commercial considerations

106. Our conclusion on this aspect of Ground 2 is therefore that there was no evidence on which the Commission could base its decision to disregard Stagecoach's conduct during the 18 months leading up to the merger in so far as the reason for doing so was that that conduct was pursued with little regard for profit and normal commercial considerations:

(a) There was no basis for inferring from the lack of contemporaneous documents that Stagecoach's directors were unconcerned about whether the routes would become profitable or not;

(b) The calculations in Appendix G purporting to show the scale of the losses incurred do not address the correct question, namely whether the routes would have been profitable if PBL (or a successor to PBL's business) had retrenched from those routes sufficiently to enable normal sustainable competition to be restored. Those calculations are also inconsistent with the basis for rejecting

the failing firm defence because they appear to assume the perpetuation of the position of serious overcapacity into the medium or long term;

- (c) The conclusion that Stagecoach was prepared to tolerate losses on the new routes for longer than was generally considered normal or acceptable in the industry was said to be based entirely or mainly on the evidence of the other bus operators. When read in full and in its proper context, that evidence did not provide any support for that conclusion.

(iv) *Stagecoach's strategy in launching its new services in June 2007*

107. The fourth possible explanation for the Commission's decision to disregard the events of June 2007 to September 2008 in adopting the counterfactual is its rejection of Stagecoach's evidence about its limited goal in launching its new buses in June 2007. A substantial part of section 5 of the Decision is devoted to a consideration of Stagecoach's market strategy when it launched its new buses in June 2007. Stagecoach's submissions are recorded as follows:

“5.45 [Stagecoach Director C] Les Warneford told us that although he did not have a market share objective in mind when the decision was made to launch the new intra-urban services, he would have been content with operating 25 buses in the intra-urban market and that a 25 per cent share of the market would have been respectable. This comment was later followed by the following written statement by [Stagecoach Director C] Les Warneford: ‘I reiterate unequivocally that in launching intra-urban services in Preston in June 2007 it was not Stagecoach's intention to either force Preston Bus out of business or to sell to Stagecoach. I expected competition to win a long-term minority share of the Preston intra-urban market to take some time and to be hard fought.’ In a subsequent hearing, [Stagecoach Director B] Tom Wileman surmised that an investment in 25 buses in Preston would have delivered a 20 per cent share to Stagecoach.

“5.46 ... Stagecoach has been unable to produce any internal document supporting the view that its ultimate ambition was a minority share of the Preston market. We found it surprising that in the space of one month, Stagecoach abandoned its long-term ambition to acquire the whole of the Preston intra-urban market in favour of such a modest target. In addition, Stagecoach did not mention this target in any of its early submissions to us. The first mention of a target of a minority share was in response to a direct question from us in a hearing.”

108. At the end of this part of section 5 the Commission concludes that it found it “difficult to reconcile Stagecoach's claimed objective to gain a minority of the Preston market” with the evidence that it analysed about route entry. We note that although the Commission refers to a minority share of the intra-urban “market” or the Preston “market” here, it is clear from the context that the Commission is referring to a 25 per cent share of the intra-

urban bus business not of the whole Preston bus market which includes both intra and inter-urban routes.

109. Stagecoach strongly contests the Commission's rejection of Mr Warneford's evidence about the company's limited goal. It argues that there was no basis for the Commission to conclude that Stagecoach's ambitions were anything other than what Mr Warneford said they were – to fill up an additional 25 buses on intra-urban routes in order to improve the profitability of the Preston depot.
110. The Commission does not say in so many words that it rejects Mr Warneford's evidence. We have already set out paragraph 5.81 where the Commission pulls back from finding as a fact that Stagecoach intended to drive PBL out of the market when it launched its services: see paragraph [58] above. But it is impossible to read paragraphs 5.45 to 5.63 and paragraphs 5.77 to 5.82 of the Decision without coming to the conclusion first that the Commission did in fact reject Mr Warneford's evidence as to the extent of Stagecoach's ambitions in June 2007 and secondly that this had an important impact on its decision as to the counterfactual.
111. We have therefore considered whether there was any basis on which the Commission could reasonably have concluded that Mr Warneford's evidence given at the July 2009 hearing was not truthful or whether, as Stagecoach assert, that conclusion was irrational. As Mr Thompson reminded us, in submitting written evidence and giving oral evidence at the Commission's hearing, the parties face criminal penalties if they deliberately give false or misleading evidence: see section 117 of the Act. We agree that no reasonable decision maker would reject Mr Warneford's evidence unless there was a firm basis for doing so in the contemporaneous documents or in other conflicting witness evidence that it preferred to that of Mr Warneford or if Mr Warneford's evidence given in the context of those statutory sanctions was inconsistent, inherently implausible or inexplicable for some other reason.
  - (a) Absence of contemporaneous documents
112. Reading those paragraphs in section 5 of the Decision, part of the reasoning behind the Commission's rejection of Mr. Warneford's evidence appears to have been the lack of contemporaneous documents evidencing that strategy. In paragraph 5.46 the Commission refers to the fact that Stagecoach was "unable to produce any internal

document supporting the view that its ultimate ambition was a minority share of the Preston market”. We have already explained why we consider that the Commission acted irrationally in relying on that lack of evidence in the context of its conclusion that the services were launched with little regard for profit or normal commercial considerations.

113. Mr Warneford’s evidence at the July 2009 hearing was as follows:

“A. (Mr Warneford) I am just about to say, my direct report was to [Stagecoach Director]. I talk with [Stagecoach Director] most weeks, maybe once -- sometimes once a fortnight. I tell him what is going on, I tell him what I am doing and we have a discussion on it and we both are very experienced. We knock around numbers in our head and are comfortable with each other’s views of what we should be doing and what we should not be doing. And occasionally [Stagecoach Director] offers me some very good advice and it is always expressed as extremely good advice and a clear instruction that I would not go there if I were you. But that did not apply to Preston. That is our business working relationship, I suppose.

Q. You are both very experienced. You knock around numbers in your head but not the kind of numbers that we have talked about with regard to Preston Bus.

A. (Mr Warneford) Well, as I said earlier, I would be very conscious of all those numbers but not uncomfortable with them and would not feel the need to write them down. If I talked this over with [Stagecoach Director], he would have the similar numbers in his head, because we both know what these things cost, how long things take, but the numbers would not be an issue between us.

Q. So, can I ask you then, what numbers did you have in you head for the Preston Bus entry?

A. (Mr Warneford) Well, no more than I have explained. I am looking in the long-term to get at least a [...] per cent, preferably better, profit on the average turnover of a vehicle, over the life of the vehicle. The uncertainty was how long does it take to reach the profit.”

114. The Commission sent Stagecoach a notice under section 109 of the Act requiring them to produce documents in various categories, all of which related to the plans to launch the Preston buses. There is no evidence as to whether more documents exist in relation to other launches of buses and so whether there was anything out of the ordinary in the absence of documents relating to Preston. In the particular circumstances of this industry and the lack of anything to contradict Mr Warneford’s description of how he and his boss discuss these things, we also consider that the Commission acted irrationally in relying on this lacuna in the evidence as a reason for rejecting Mr Warneford’s evidence about Stagecoach’s intentions as at June 2007.

115. The Commission commented in paragraph 5.46 of the Decision that the minority market share target was only produced late in the day. It is clear from Mr Warneford's evidence at the July 2009 hearing that he was not thinking in terms of acquiring any particular share. Rather he was thinking in terms of how much business was needed to fill up the 25 minibuses which he proposed to introduce on the intra-urban routes in order to bolster the profitability of the Preston depot. What percentage that amount of business represented of any particular market or sector was not something he had considered. In our judgment, that supports rather than contradicts Mr Warneford's assertion that the planned expansion was aimed at increasing the profitability of the Preston depot by establishing a certain number of new buses on intra-urban routes rather than at winning a level of market share which would weaken or destroy PBL.

(b) Scale and duration of losses

116. The Commission also relied on the scale and duration of the losses incurred by Stagecoach on the intra-urban routes as casting doubt on Mr Warneford's evidence that the intention behind the new routes was to improve the profitability of the Preston depot. In Appendix G the Commission stated:

“... after 80 weeks (the period between the launch of the new services and the acquisition of PBL) we would have expected to see these new services covering their [average variable costs] and making some contribution to overheads, *unless there is a particular strategic rationale for prolonging the loss-making period associated with operating the new routes*”. (emphasis added)

117. The implication here was that the “strategic rationale” behind Stagecoach's actions was in truth to weaken or marginalise PBL and that the extent and duration of the losses is explicable only on that basis. We have discussed earlier that we consider that the calculations in Appendix G are flawed because they examine profitability without investigating what might have happened if PBL had reacted differently and cut back its services, as Stagecoach claimed to have anticipated (see paragraphs [83] onwards, above). We cannot see how showing that continued high levels of overcapacity led Stagecoach and PBL to incur heavy losses is inconsistent with Stagecoach's version of events, namely that it launched the 25 buses with the intention improving the profitability of the Preston depot and was prepared to sustain losses until PBL allowed it to establish the routes, provided that the routes did not appear to be inherently unsustainable.

(c) Scale and nature of Stagecoach's entry onto the intra-urban routes

118. Thirdly, the Commission refers to the scale and nature of Stagecoach's expansion onto the intra-urban routes as casting doubt on Stagecoach's assertion as to its strategy at the time it launched its services. In paragraphs 5.47 to 5.53 of the Decision, the Commission described the expansion of Stagecoach's intra-urban business, pointing out that:

- (a) The five services were launched over a short period of time with high frequencies comparable to those already operated by PBL; Stagecoach also increased the frequencies of their existing intra-urban services;
- (b) These services replicated – in their entirety or on their key corridors - nine out of PBL's 11 commercially viable services; they duplicated PBL's most profitable commercial routes representing over 80 per cent of PBL's direct contribution;
- (c) PBL operated 49 vehicles on the routes that Stagecoach targeted with its new services so that the 25 additional buses increased the level of supply on those routes by about 50 per cent;
- (d) Stagecoach offered low fares on its new services, in some cases nearly halving PBL's fares;
- (e) The number of new buses allocated by Stagecoach to its Preston intra-urban services could not in itself be relied on as a useful indicator of the ultimate market share ambitions of Stagecoach because it could have supplemented the 25 new buses with more vehicles from other parts of its fleet and in fact had had to introduce 3 more buses to a particular route.

119. The Commission concluded from this (paragraph 5.53):

“The scale and nature of Stagecoach's expansion .... would not seem to us to suggest that it was only aiming at gaining a minority share of the Preston intra-urban market. In our view it was predictable from the outset that Stagecoach's entry on all of PBL's key routes would cause considerable damage to the viability of PBL, rather than merely enable Stagecoach to acquire a minority share of the market.”

120. There are important flaws in this line of reasoning. The first is that paragraphs 5.47 to 5.53 combine facts which it is fair to assume that Stagecoach knew at the time it launched its new services (such as the routes and frequency of PBL's services and PBL's

fares) with facts which the Commission does not assert were or must have been known to Stagecoach. There is nothing in the Decision to indicate that Stagecoach was aware at the time that it launched its services, or after the launch, that the routes being targeted were PBL's most profitable routes or that those routes represented any particular share of PBL's direct contribution. Importantly, Mr Unterhalter confirmed at the hearing that it was not part of the Commission's case that Stagecoach knew that if PBL retrenched its services on those routes sufficiently to accommodate Stagecoach's 25 buses, PBL's business would become unviable: see Transcript of 10 March 2010, page 35. It was put to him by the Tribunal that the state of Stagecoach's knowledge must be relevant if the inference being drawn from the identity of the routes targeted and from the amount of capacity introduced was that the inevitable result, or almost inevitable result was that PBL would exit the market (see Transcript of 10 March 2010, page 35). Mr Unterhalter's response was that the Commission did not need to establish what Stagecoach's intention was in launching the services provided it could show that the effect of those services was to push PBL out of the market entirely. With respect to the Commission, we cannot see how that reasoning is sound. The Commission is relying on the scale and scope of Stagecoach's new services to reject Stagecoach's evidence that its intention was limited to filling the 25 new buses with passengers. We cannot see how the Commission can argue that the scale and scope of the expansion is inconsistent with Stagecoach's stated ambition unless it can show that Stagecoach knew that the introduction of this amount of new capacity on these particular routes would effectively knock out the bulk of PBL's profits, whether or not PBL decided to retrench rather than fight it out.

121. In our judgment there is nothing about Stagecoach's decision to target the busiest intra-urban routes or to launch all their new services at around the same time or to undercut PBL's fares which is surprising from a business point of view. Stagecoach's explanation as to why it introduced the services at the same time rather than adding them in gradually over a number of months was entirely rational, namely that a marketing campaign was undertaken at the time of the launch. Launching several services together under a common brand had benefits in terms of promotional costs and impact. Stagecoach's decision to discount fares heavily at first and then gradually bring them back up to a level slightly below PBL's is also a standard commercial approach when introducing a new product in competition with an incumbent. Stagecoach launched 25 new buses on routes where there were already 49 buses operating so that it added a further 50 per cent

capacity on those routes. Given that passenger numbers might be expected to expand a little with the greater frequency, this is entirely consistent with an intention to achieve a minority share of the intra-urban business. We do not consider that the Commission acted reasonably in treating the scope and nature of Stagecoach's entry onto the intra-urban routes as a factor indicating that the company's ambitions went beyond those Mr Warneford described.

(d) Inconsistencies in Stagecoach's evidence

122. Paragraph 5.11 of the Decision says:

“Appendix F (paragraphs 2 to 7) explains the difficulties we encountered in gathering evidence from Stagecoach in order to understand its actions and sets out in detail the range of evidence we considered. We found it particularly difficult to reconcile statements made to us by various Stagecoach directors with available contemporaneous documents (including minutes of meetings and internal emails) and the evidence received from other parties, in particular evidence provided to the North West Traffic Commissioner by [former PBL Director X]. We noted some inconsistencies between Stagecoach's written submissions to us and the North West Traffic Commissioner and subsequent verbal statements made by its directors, which are described in detail in Appendix F.”

123. The implication from this is that material elements of Stagecoach's evidence are contradictory or inconsistent with other evidence in a way which casts doubt more generally on the veracity of Stagecoach's submissions made in the course of the investigation. We have therefore examined the Decision and Appendix F carefully to see what is being cross-referred to here.

124. Appendix F describes the different evidence as to what was said by Stagecoach director Tom Wileman at the meeting with PBL on 21 July 2006 and in particular whether a threat was made that if PBL rejected the offer from Stagecoach, Stagecoach would force them to sell the business through competitive means. What happened at the meeting was explored at length with Mr Warneford in the July 2009 hearing: see pages 99 to 101 of the Transcript. Appendix F does not state that the Commission has concluded that what Mr Warneford said at the hearing about this was false. In paragraph 5.12 of the Decision, one of the observations made by the Commission is that given the conflicting accounts of what occurred at the meeting, it does not “place any decisive weight on this.” If this passage in Appendix F is intended to be an instance of inconsistency between what Stagecoach said and evidence received from other parties, we cannot see how such an allegation can be made.

125. Next in Appendix F there is a paragraph describing a letter sent by Mr Warneford to the Lancashire Evening Post in November 2007 in which he stated that Stagecoach had not expressed an interest in PBL for many years. At the July 2009 hearing in a short exchange about this (page 102) Mr Warneford made no bones about the fact that this statement was untrue and that he knew this to be the case when he wrote it. Regrettably though this untruth may have been, we do not consider that the fact that Mr Warneford wrote a false statement in a letter to a local newspaper can reasonably be regarded as casting serious doubt on the truthfulness of his evidence to the Commission when Mr Warneford was clearly aware of his statutory obligations to tell the truth.
126. Later on in Appendix F (paragraphs 43 onwards) there is a description of meetings that took place between Stagecoach and PBL between December 2007 and July 2008. The Commission describes a shift in the evidence on Stagecoach's part. At first Stagecoach said that there had been a brief exchange during a meeting on 4 December 2007 about Stagecoach acquiring PBL. Later Stagecoach said that they had put aside all thoughts of buying PBL after the June 2006 offer was rejected. Contemporaneous notes were provided which the Commission said were inconclusive on this matter. The former PBL director's recollection of the meeting was that "an offhand comment might have been made" but no more than that. So there is here a minor inconsistency between Stagecoach's initial evidence that there was a brief mention of Stagecoach buying PBL in the December 2007 meeting and their later submission that there were no proposals after June 2006 to buy PBL.
127. Appendix F then discusses the complaints that were made to the North West Traffic Commissioner from the time Stagecoach applied to register the routes until May/June 2008. We can find nothing in these paragraphs (paragraphs 48 to 60 of Appendix F) which describes an inconsistency between what Stagecoach is reported to have said to the Traffic Commissioner and what it subsequently said in submissions to the Commission in the course of the investigation. We simply cannot see to what the final sentence of paragraph 5.11 of the Decision is referring.
128. The reference in paragraph 5.11 of the Decision to inconsistencies of evidence explained and described in detail in Appendix F therefore appears to rest on the fact that at one stage Stagecoach said that it had not pursued the purchase of PBL after June 2006 and at another stage Stagecoach's evidence was that "no more than a brief exchange" had taken

place on this at a meeting in December 2007. In our judgment, this is not a factor that any reasonable decision maker would consider material and it is an entirely inadequate basis for the strong words used in paragraph 5.11. Reading that paragraph, one would expect to find in Appendix F a series of clear conflicts of evidence between Stagecoach's submissions and contemporaneous documents or other witness evidence from which it is possible to conclude that Stagecoach's directors' evidence should not be accepted. There are no such conflicts of evidence identified in Appendix F or in the body of the Decision. The Commission has not pointed us to any other material outside the bounds of the Decision on which it relies in rejecting Mr Warneford's evidence. This is not a situation where the Commission has weighed up conflicting evidence and decided that Stagecoach's submissions were not credible on the basis of that evidence. Nor is this a situation where the Commission has highlighted ways in which Stagecoach's evidence has been inconsistent in itself in a material respect or reasons why it is inherently implausible. In such cases, the Tribunal would not interfere with the Commission's assessment. Rather, we find that there is in fact no material inconsistency described in Appendix F which could provide support for the rejection by the Commission of Stagecoach's submissions as to what its intentions were when it launched its services in summer 2007.

**(e) Summary of conclusions on Ground 2**

129. We unanimously conclude that Stagecoach's challenge on Ground 2 succeeds. Applying the judicial review principles that we outlined in paragraphs [42] onwards, above, we find that the reasoning by which the Commission decided in section 6 to disregard the events leading up to the merger and to conclude that the correct counterfactual was the pre-June equilibrium cannot stand.
130. In so far as the Commission may have been relying on a general principle that the lawful behaviour of an acquiring firm prior to the merger must or can be disregarded if that behaviour has the effect of bringing about the merger, the reasoning in support of such a principle was entirely absent from the Decision. There is an unexplained disparity between the reasoning behind the rejection of the failing firm defence in Appendix H (which is based on the position that actually existed as at September 2008) and the conclusion on the counterfactual (which assumes that Stagecoach did not launch any intra-urban buses in June 2007). As we indicated earlier (see paragraphs [55] onwards

above) it is not clear either from the Decision or from the arguments before us whether this principle was relied upon by the Commission.

131. We therefore put on one side the fact that we are not sure why or in what way the Commission's findings as to the nature of Stagecoach's behaviour after June 2007 were relevant to the choice of the counterfactual. But there is no doubt that the choice of counterfactual did follow from the Commission's finding that Stagecoach's expansion onto the intra-urban routes in June 2007 was undertaken with little regard for profit and normal commercial considerations. In our judgment, that finding was not one which was reasonably open to the Commission to make on the basis of the evidence that we have seen:

- (a) Having regard to the particular facts of this industry and in the light of evidence from Stagecoach's management which was not contradicted by any other evidence, it was not reasonable to rely on the lack of contemporaneous strategy or revenue/profit forecast documents as a factor supporting such a finding;
- (b) The calculations in Appendix G did not explore what was a relevant factor in considering Stagecoach's commercial considerations in launching its new services, namely what would have happened to the profitability of the routes if, as Stagecoach claimed to have expected, PBL had cut back its services in the intra-urban sector to any extent;
- (c) The evidence from third party bus operators on which the Commission relied for concluding that Stagecoach endured losses on its new routes for longer than was normal in the industry did not, when read in full and in context, support any such conclusion;
- (d) In so far as the Commission's reasoning was based on a rejection of the evidence from Stagecoach's director that the company's intention in June 2007 was to establish 25 new buses operating out of the Preston depot, the Commission's reasoning was insupportable in that there was no basis on which the Commission could properly reject that evidence.

132. We have considered whether the findings that are unsupported are material to the conclusion on the counterfactual. Each of them appears from the structure of the Decision to have been an important plank in the Decision, since much of the Decision is devoted to considering them. Our conclusion on each of them, therefore, indicates that there is a serious flaw in the Commission's reasoning.
133. We therefore find that there is nothing in the Decision which explains or justifies the Commission's conclusion in paragraphs 6.4 to 6.13 of the Decision that it was appropriate to disregard what actually happened in this market prior to the merger rather than to consider how the market would have settled down from September 2008 forward, if the merger had not taken place, the period of abnormal competition had come to an end and two operators had continued to provide bus services on the intra-urban routes.

**5. GROUND 3: PROCEDURAL UNFAIRNESS IN PREFERING PBL WITNESSES OVER STAGECOACH WITNESSES**

134. Stagecoach's third ground of review is that the Commission acted unfairly in preferring evidence of PBL's witnesses over that of Stagecoach's witnesses. Stagecoach accepted that this ground overlapped with Ground 2 to a large extent. In the light of our findings on Ground 2 we have not found it necessary to come to a conclusion on this ground.

**6. GROUND 4: REMEDY PROPOSED IS DISPROPORTIONATE**

135. Stagecoach's final challenge to the Decision is a complaint that the remedy proposed by the Commission was disproportionate. The question of remedy is discussed in section 10 of the Decision. This ground was largely dependent on the success or otherwise of the other grounds, as we discuss further below. But there was one particular point on which Stagecoach took issue with the remedy even if its other grounds all failed.
136. Stagecoach complains that the divestiture package proposed by the Commission included two routes (namely the Circular Services 19 and 22 to the Royal Preston Hospital) which, Stagecoach says, were not routes which were being run by PBL at the time of the acquisition but were new services started by Stagecoach and which were significantly superior to the routes offered by PBL.

137. If we had rejected all the other grounds of review, this point would not have led us to interfere with the remedy proposed by the Commission. The construction of a package of assets which will be sufficiently attractive to a potential purchaser to enable the anti-competitive outcome ultimately to be remedied is a difficult task involving an exercise of judgement by the Commission. This is particularly so where the merger has been completed and the purchased business has, to some extent, already been integrated into the business of the acquirer. There is nothing here which would cause us to disturb the Commission's conclusions on the appropriateness of including Routes 19 and 22 in the package.

138. We turn then to consider the effect that our decision to uphold Ground 2 has on Stagecoach's challenge to the remedy proposed under Ground 4. It is clear from reading section 10 of the Decision as a whole that the adoption of the pre-June 2007 equilibrium counterfactual in section 6 strongly influenced the Commission's analysis of the remedy. In paragraph 10.8 of the Decision the Commission said:

“10.8 In accordance with our guidelines, therefore, we would normally expect that the divestiture of a commercially viable PBL would be effective in remedying the SLC because it would re-establish the structure of the market expected in the absence of the merger and thereby restore the level of competition (actual and potential) that existed prior to the launch of Preston intra-urban services by Stagecoach in the summer 2007.”

139. Later in section 10 the Commission said:

“10.43 ... In our judgement, a divestiture of a reconfigured PBL would result in Stagecoach facing a competitor of sufficient scale and with sufficient coherence of operations to restore substantially or fully the degree and nature of the potential and actual competition lost as a result of the merger. Such a divestiture would therefore be an effective remedy. We reached this conclusion for following reasons.

10.44 First, the level of head-to-head competition between Stagecoach and the divested business would be of a similar scale to that which existed between Stagecoach Preston and PBL in May 2007.

10.45 Second, while the precise operations and market shares of the two parties would not be identical to those in May 2007, we concluded that the threat of potential competition between Stagecoach Preston and the owner of the divested business would be substantially the same as that between Stagecoach Preston and PBL at that time. A divestment of a reconfigured PBL would reinstate rivalry between two operators each with extensive and coherent neighbouring networks of commercial services within and around Preston from their own large depots.”

140. It is true that section 10 records that it was not possible or necessary to reinstate the June 2007 position precisely and that the Commission would not necessarily be concerned

about an outcome that resulted in Stagecoach having a stronger presence in Preston than in 2007 (see paragraph 10.48 of the Decision). But the desirability of reinstating the pre-June 2007 equilibrium permeates the discussion of the scope of the remedy.

141. Section 35(3) of the Act (set out in paragraph [16] above) requires the Commission to decide what action to take for the purpose of remedying, mitigating or preventing the SLC. So in so far as the choice of the counterfactual affects the degree to which there has been an SLC resulting from the merger, that choice may also affect the decision as to what action is appropriate to remedy it. In the light of that, the Commission rightly conceded at the hearing before us that if the Tribunal were to find that the Commission's choice of the pre-June 2007 counterfactual was irrational, the case would have to be remitted to the Commission to look again at the scope of the remedy. The package ultimately put together by the Commission will not necessarily be different from the package laid out in section 10. But the Commission may need to address itself to that question.
142. We therefore unanimously reject the challenges to the remedy other than the challenge that follows from the success of Stagecoach on Ground 2.

## **7. CONCLUSION AND RELIEF TO BE GRANTED**

143. The Tribunal's unanimous judgment is therefore that –
- (a) Ground 1 of the application fails;
  - (b) Ground 2 of the application succeeds to the extent and for the reasons set out in this judgment;
  - (c) It is not necessary to determine Ground 3;
  - (d) Ground 4 succeeds to the extent that follows on from the success of Ground 2.
144. The order that would normally follow would be to quash parts of the Decision and remit them back to the Commission for reconsideration. In its Notice of Application, Stagecoach stated that despite its challenge to the Decision and the remedy imposed, it intended to proceed with trying to find a buyer for the business in accordance with the

undertakings which it had given to the Commission and which it did not seek to have suspended on an interim basis. In the light of that, it is appropriate to hear further submissions from the parties as to the appropriate order to follow from this judgment.

Vivien Rose

Andrew Bain

Michael Blair

Charles Dhanowa  
Registrar

Date: 21 May 2010