IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1145/4/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

9th March 2010

Before:

VIVIEN ROSE
(Chairman)

PROFESSOR ANDREW BAIN OBE
MICHAEL BLAIR QC

Sitting as a Tribunal in England and Wales

BETWEEN:

STAGECOACH GROUP PLC

Applicant

- v –

COMPETITION COMMISISON

Respondent

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HEARING
DAY ONE

APPEARANCES

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

Mr. David Unterhalter SC, Miss Kassie Smith and Mr. Ewan West (instructed by TSol) appeared for the Respondent.

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THE CHAIRMAN: Good morning. Mr. Thompson?

MR. THOMPSON: Good morning, Madam Chairman, gentlemen. I appear for Stagecoach with Mr. Christopher Brown. Mr. Unterhalter, Miss Smith, and Mr. West appear for the Competition Commission. I think Mr. Swift made a passing appearance in the pleadings, but, as I understand it, there has been a 25 percent cut in the representation on behalf of the Competition Commission for present purposes.

I would not claim any particular originality for the structure I am intending to follow. First of all, some introductory remarks and some comments on the facts. Then, ten core propositions which broadly correspond to our four grounds, but I hope they will be helpful in terms of focusing the issues between the parties. I hope that the Tribunal has four main bundles, and now a fifth supplementary bundle of authorities - what I will call the Notice of Appeal bundle, the defence bundle, the skeleton bundle (which was the Stagecoach skeleton bundle) and an authorities bundle, and then, yesterday, I think a supplementary bundle of authorities. Is that right?

THE CHAIRMAN: Yes, I think we have those.

MR. THOMPSON: Then there is a Notice of Appeal, defence, there are skeletons, and then two notes were sent to the court yesterday. I think both formally confidentially - one confidential, as it were, to the parties rather than as against the clients, one in relation to the third party disclosure, confidential as against my clients. I do not know whether the Tribunal wants to consider now how that material should be dealt with or whether we will just see how we get on and deal with it as and when.

THE CHAIRMAN: We will see how we get on, but when we come to it, we will go In Camera, I think.

MR. THOMPSON: I was not sure whether the Tribunal thought that was necessary, but certainly I will bear that in mind.

I am obviously assuming that the Tribunal has read the decision and the pleadings. I will be careful in relation to confidentiality as we have discussed. The pleadings, I think, indicate some, but not a great deal, of narrowing of the issues. There are still four grounds, but the main points, we would say, are, first of all, was the decision based on an error of law; and, secondly, was the decision perverse as a matter of fact?

So far as the legal issue is concerned, Stagecoach submits that the Competition Commission clearly has no jurisdiction to assess the impact on competition between independent undertakings under s.35 of the Enterprise Act, nor, indeed, to investigate allegations of unilateral abuse of market power. That power is clearly and expressly conferred on the OFT

under Sections 2, 18, and 25 of the Competition Act 1998. However, the novel approach of the Competition Commission in this case was clearly based on an assessment of the impact on competition of Stagecoach's conduct as a competitor to PBL in the eighteen month period prior to the merger - the so-called period of abnormal competition, and, as such, the decision is unlawful. I will obviously put it in slightly more sophisticated terms as we go, but that is the gist of it.

So far as the factual issue is concerned, we say that the Competition Commission's approach was obviously perverse. The decision is based on the proposition that if the merger had not been created on 23rd January 2009 Stagecoach would not have entered the relevant market as it in fact did on 24th June 2007. That is obviously a perverse - indeed, we would say, nonsensical - finding, the equivalent of finding that if there had been no invasion of Iraq in 2003 George W. Bush would not have been elected President of the USA in November 2000. Again, such an irrational finding is unlawful, and must lead to the quashing of the decision.

Considering this matter in advance of the hearing it is a point - and it is not exactly how it is put in the Decision, but it appears to be implicit in the way that it is put in the defence - that the Competition Commission's finding could also be characterised as equivalent to finding that had the acquisition fallen through on 23rd January 2009 for some reason - as, for example, Arriva's offer fell through in the Summer of 2008 - that would have had the magical effect of reinstating the monopoly position of PBL and of causing Stagecoach suddenly to withdraw all its services to its 2007 levels. Stagecoach submits that it would have been no less absurd and irrational for the Competition Commission to have made such a finding. Indeed, if I may put it this way, this would be, as it were, the succeeding firm defence. Having rejected the failing firm defence, the Competition Commission would find that the succeeding competitor was not only forced out of the market, but would, in effect, be required to reinstate an inefficient firm in the conditions that it had been in some two years before. We say that would be an equally nonsensical approach for the Competition Commission to have adopted.

Those are the two core issues in the case. But there are three subsidiary issues. First of all, even assuming the Competition Commission had jurisdiction under s.35 to assess the Stagecoach conduct from 2007 (which we say it obviously did not), and, secondly, if it was a rational possibility that Stagecoach would not have entered the market in June 2007, or indeed remained on the market in 2009, in the absence of the merger in 2009, we further submit that it was perverse for the Competition Commission to find in relation to the period

from June 2007 to the end of 2008 to make these finding: first of all, that Stagecoach did not act in a rational or commercial way in entering the Preston market as it did (which I think is indisputably one of its key findings), and, secondly, the Competition Commission was perverse to find that Stagecoach must have foreseen that the effect of its entry would be to put PBL out of business. We say that both of those findings are perverse. They are perverse not in the sense of being bizarre as the sort of time-turning finding which we primarily attacked, but in a more straightforward sense they have nothing to support them and there is ample evidence to show that they are false.

There is a further difficulty with these two findings. Although the Competition Commission seems to rely on these points to justify its decision to use a counter-factual based on a historical fiction that Stagecoach did not act as it in fact did from 24th June 2007, or that it would have withdrawn from the market in the absence of the merger, the Competition Commission in fact provides no explanation at all for why this follows as a matter of fact of law. Stagecoach submits that it is a complete non-sequitur and that the decision should be quashed on this basis also.

The other two points on which Stagecoach relies are procedural unfairness and the perversity and lack of proportionality of the remedy. These essentially flow from the above points or are further reflections of the poor quality of the investigation and report of this case.

Finally by way of introduction I would like to set the matter in a somewhat broader context. I would emphasise that although this is a case about a local bus market it has very wide implications. If the Competition Commission's approach were legally correct it would apparently entitle the Competition Commission to block a merger whenever it disapproved of the earlier conduct of one of the parties to that merger and consider that such conduct - not the merger - had led to an SLC, and it could do that without having to show that such conduct was in any way unlawful. This would be an enormous expansion of the jurisdiction of the Competition Commission for which there is no justification either in legislation or as a matter of policy. The OFT has a well-defined jurisdiction over the conduct of firms and exercises powers under the constraints of the Competition Act 1998. It is no part of the Competition Commission's functions to supplement that role. The Competition Commission also lacks the resources and cannot provide the procedural safeguards appropriate for such investigations as this case also illustrates.

I would also note that the consequences of the Competition Commission arrogating such a role would be to create a perverse incentive against the acquisition of weak companies

before they fail. To take the present example where the CC's approach correct, Stagecoach would have been perfectly entitled to act exactly as it did to allow PBL to fail and then to acquire the relevant routes and assets on liquidation. Neither the OFT nor the CC would have had any jurisdiction over the matter. I say that in the absence of documents, and that has never been alleged.

Finally, by way of introduction I could summarise Stagecoach's position in this way. First of all the CC has failed to do what it was required to do in that the decision reaches no concluded view as to the impact of the merger and one sees that in appendix H where the matter is dealt with but no conclusion is reached. On the other hand the CC has instead conducted an investigation into predatory pricing. This was an investigation conducted in a partial manner by a regulatory body with no jurisdiction over the issue and in relation to a non-dominant firm. That is what one finds in effect in appendix J and appendix G.

THE CHAIRMAN: By "partial" there do you mean as opposed to in a whole manner, or as opposed to in an impartial way?

MR. THOMPSON: It is partly a procedural objection, we do not feel we were given a fair hearing, effectively our ground 3, but also incomplete in that it is not any part of the CC's business and none of the correct procedures were followed for such an investigation even supposing the CC had any jurisdiction over the matter.

So much by way of introduction. I was then proposing to deal quite quickly with the facts because obviously they are set out in detail in the decision and in various other places, and I was going to cover 12 points, and effectively simply give references to the Tribunal unless it would be helpful to look at anything in particular.

THE CHAIRMAN: Would it be helpful for us to have the decision open, or your skeleton open?

MR. THOMPSON: I think probably the decision in the first instance which one finds at tab 1 of the notice of appeal bundle. My first heading was "Stagecoach" and the reference was simply to 2.1 to 2.7 of the decision and where there is a brief characterisation of Stagecoach, and I do not think there is any need to read it out.

THE CHAIRMAN: There is nothing controversial in those?

MR. THOMPSON: I do not think there is anything particularly controversial, the only issues might be the rhetoric, as it were, from paras. 2.5 to 2.7, but I do not think in terms of the character of the company paras. 2.1 to 2.4 set out the essence of the company, and likewise paras. 2.8 to 2.14 give a description of PBL. The only points I would note, I think, are at 2.12, the trading profit that is at 2.12 is set out as £234,000 on revenues of £11.36 million and by fairly elementary calculation that is a profitability of only 2 per cent, and I think the

Tribunal will have seen that it was quite heavily dependent on a contract for repair of Council vehicles and so you will have seen that issue in the pleadings. Likewise, 2.14 there is a description by Stagecoach that PBL was averse to change, had a tolerance for inefficiency, and then others commented on the public service ethos of the company which manifested itself in a high level of reliability of service provision across its comprehensive network. The only point I would make there is that there is no real inconsistency between the two findings and it is in a way characteristic of the CC decision that it, as it were, draws false inconsistencies; there is nothing inconsistent between an inefficient company providing a good service, and in fact this is dealt with in the evidence of [former PBL Director] before the CC and one finds that at tab 13 of the defence bundle and p.21. We see a Ms. Canet, who I think is a member of the inquiry team, I think she is described as a senior business adviser of the staff, and she asked a question of [former PBL Director] at line 7:

> "You keep saying that the company needed to change and I can see where you were coming from but if you look at what the service that was offered to customers, you had a high density network, low fares, buses which were – as far as I can tell – fairly new, it is not entirely clear to me what was wrong with the company. I mean, apart from the fact, yes, it did not operate like other companies and had its own little quirks but from a customer point of view I fail to see what was wrong."

So that is finding that it was a good service. There is a lot of discussion here but at p.23 line 6 [former PBL Director] says this:

> "So, please do not get me wrong, the customer – what the customer got in terms of service, in terms of frequent service, low floor vehicles, fares etcetera, was exceptionally good. It is just internally to manage t he business longer term, some of the things that needed addressing in terms of terms and conditions, agreements and developing the workforce to be IT literate and everything else like that, and reduce some of the numbers, did not happen because, equally, they were the shareholders."

So in my submission there is a completely false dichotomy that the CC draws between a good service and an inefficient company. The point we are making is that this company was not sustainable, it just was not making enough money and because of the fact that its shareholders were its employees there was an inbuilt resistance to change and that was

essentially why the company could not survive when it was faced with actual market competition.

The third point, the Preston bus market, and that is dealt with in some detail at section 4 of the decision which is at p.12. I do not think there is any need, for present purposes, to go either into the detail of the facts or the detail of the market analysis which appears in the annexes, at Appendix I, the section on market definition, I would simply draw the Tribunal's attention to that material insofar as it is relevant and then there are a couple of references that I pick up, first of all in appendix G which you will find at paginated 130 in tab 2. This is the effect of Stagecoach's operation on the new intra-urban routes. What I refer you to is p.G4, so p.133 of the bundle and you will see it is a table about market growth on intra-urban Preston area services. I think the main contrast that the CC drew was between the position in May 2007 and May 2008. You will see the second heading: "Market growth on intra-urban Preston area services" by passenger numbers PBL had – does the Tribunal have this?

THE CHAIRMAN: Yes, I have them in yellow, so best not to read out the numbers.

MR. THOMPSON: From 2009 I have them in yellow, I do not have them in yellow for 2007.

THE CHAIRMAN: Right.

MR. THOMPSON: In 2007 the numbers are just under 800,000 out of a total of approximately 850,000. so approximately 90 per cent of the market and approximately 10 per cent for Stagecoach, whereas a year later the market had gone up to some 940,000 and by my calculations PBL's percentage is about 75 per cent and Stagecoach's is about 25 per cent. So, broadly speaking, the internal Preston market rose with the market shares. If one takes a somewhat more technical approach, as is taken in appendix I, which is at p.166 ----

THE CHAIRMAN: Wait a minute, are you then saying that the intra-urban services are a separate relevant market from the inter-urban services? I did not think that was ----

MR. THOMPSON: I was simply illustrating what was going on on the ground at the time. As I said, the more technical material is in appendix I. One finds that at para.54 on p.177. There you have estimates of supply-side market shares of Stagecoach and PBL on various different assumptions going from 23 per cent up to 43 per cent, and maybe 48 per cent, depending on what assumptions are made. As between Stagecoach and PBL I am just simply pointing the Tribunal to a broad indication of the sort of allocation between the two in the market primarily affected by this competition. I am not making any very technical point here, I am simply giving some information to the Tribunal.

THE CHAIRMAN: What was the conclusion in annexe I as to what the market was?

MR. THOMPSON: It is not altogether clear, but para.75 sets out the conclusion.

THE CHAIRMAN: Anyway, go on and see where we get to.

MR. THOMPSON: It is more of a factual submission than a submission about market definition, because I do not think really anything much turns on that because there is no allegation of dominance here and so, in a sense, what the precise market definition was. It is more to illustrate how the market was developing over the ----

THE CHAIRMAN: Yes, it is the share of the passenger numbers in the intra-urban routes.

MR. THOMPSON: The fourth topic I had after Stagecoach, PBL and the market was the approaches that were made prior to 2006, and that is set out at para.10 of appendix F, p.117 of tab 2, in a convenient form. The Competition Commission quotes, apparently without criticism:

> "Stagecoach told us that each year in the six year period between 2000 and 2006 during the budget development process (which takes place in January/February) the management of the north-west division discussed the possibilities of competing in Preston or buying PBL. Every year managers agreed that buying PBL was the preferred option if it came up for sale. This had been followed with meetings with ..."

I think that is [former PBL Director] –

> "... in 2001 and 2006. Stagecoach told us that when it approached PBL in 2006, it did not expect a positive response, based on its previous experience."

Obviously it did not get one.

There is more detail about that 2006 approach at paras.14 and following over the page. It really goes from 14 through to 21.. It appears to us that the Competition Commission took an adverse view of what happened at that meeting. Although it did not reach any firm conclusion as to whether or not Stagecoach effectively threatened PBL, but it seems to have been part of the background that the Competition Commission relied on to show that there was something not quite right about Stagecoach's conduct from this time onwards, although it is somewhat smoke and mirrors as to exactly what the Competition Commission objected to.

The next topic is Stagecoach's decision to enter the Preston city market and that is dealt with, if we go back, at para.8 of this same appendix. I think paras.8 and 9 are both important in that they set out a rationale for the expansion, which I think is probably agreed, although it does not seem to play a prominent part in the decision. One sees that at the second half of para.8:

"Stagecoach considered that a sale by PBL to another buyer was possible at some point and that it was likely that a future purchaser of PBL ..."

so Arriva or Go Ahead or someone like that –

"... would take a more proactive approach to network development and perhaps threaten Stagecoach's operations around Preston. In the light of these considerations, Stagecoach had decided that the best approach to adopt was to expand its own business thereby consolidating its position and attempt to take a greater share of the Preston intra-urban market than had previously been the case."

Then there is reference to [Stagecoach Director]'s evidence.

In my submission, that is important because that is a very clear and comprehensible rationale and if the Competition Commission had focused its attention on that issue a lot of its findings about how irrational it all was would have gone away, because it was actually a perfectly rational thing for Stagecoach to be worried about, and its conduct thereafter is perfectly comprehensible if one keeps that at the forefront of one's mind. A lot of the paradoxical findings that the Competition Commission gets tied up with seem to be involved, rather forgetting that that was a perfectly intelligible reason for what Stagecoach did.

Then it is dealt with again at paras.22 to 30 in some detail. Again, I do not think it is necessary to go into this in any great detail, but this confirms the detail of what was planned, namely to order 25 new buses with a view to going head to head in the, as it were, commercial centre of the PBL network, and for some reason the Competition Commission seems to think that that was an irrational thing to do, whereas, in my submission, if that was really what you wanted to do, which was to establish a firm position before a third party bought out an inefficient company, it was an eminently rational thing to do to try and get a firm foothold in that market before the evil day came.

THE CHAIRMAN: I am not sure they say it was an irrational thing to do. I think what they say is that it was rational, what they are trying to infer from that is how big a share of the market you were intent on getting, or you wished to get. Whether that was a rational thing to do if, as you said, you only wanted a small share of the market or whether it was only a rational thing to do if, in fact, you were intending to take over from PBL.

MR. THOMPSON: We will come on to this in submission. Where I have difficulty is why it really matters -- why this justifies what the Competition Commission did. If it was not an irrational thing to do, why is there any reason to assume that Stagecoach did not, would not, might not have done this. If there was a perfectly intelligible rationale for what they

actually did, what possible basis is there for making an assumption that they did not or would not have done it? When we come to it, that is the substance of the point.

The next area is the description of competition in 2007. Obviously that takes you into the whole area of the allegedly abnormal period of competition, but it is summarised, I think at para. 27 of Appendix F where it sets out what Stagecoach was planning to do. Broadly speaking, that is what Stagecoach did. One finds that described at para. 34 in some detail.

The next point chronologically is the meetings between PBL and Stagecoach. One finds that described briefly at para . 5.9 of the decision, at p.18 of Tab 1, where the Competition Commission describes four meetings between Stagecoach and PBL took place between December 2007 and July 2008.

> "Stagecoach told us in the first of those meetings, PBL confirmed it was not for sale. Stagecoach suggested the possibility of a statutory Quality Partnership; and also put forward the option of PBL acquiring Stagecoach's Preston intra-urban operations. The proposal was for a TUPE transfer of the 55 drivers, the purchase of the [X] buses at a price of £[X] per bus (or £[X] million across the [X] buses). The option of renting rather than buying the buses was also mentioned. [former PBL Director] also told us the proposal included a £[X] contribution towards the drivers' training costs, but Stagecoach denied this. Although the former management of PBL said it considered the offer to be very good, it turned it down on legal advice. We noted that Stagecoach had paid £[X] million for the buses, that its new services were heavily loss-making and that it expected that PBL would need to make at least some of the drivers redundant".

So, the last sentence is slightly paradoxical, but it seems to be saying that although PBL itself thought the offer was good, the Competition Commission, for a reason it does not really explain, did not think it was very good, or that it did not agree with [former PBL Director].

One sees more detail about that at Tab 20 of this same bundle. This is [former PBL Director]'s description of the events. He describes in particular the meeting of 4th December, 2007. In the middle,

> "[former PBL Director] recalled that in the Competition Commission's provisional findings there had been a reference to Stagecoach offering to buy PBL; he did not remember anything as blunt as that. [former PBL Director] had seen Stagecoach's comments on the provisional findings where Stagecoach stated

that an offer had not been made to PBL at the December 2007 meeting. [former PBL Director] agreed with that comment from Stagecoach".

Then he qualifies it to some degree. There is also in relation to this issue a contemporaneous note in manuscript which is at Tab 7 of the same bundle, which gives a detailed account of the meeting.

THE CHAIRMAN: What it said in 5.9 was that the offer was that Stagecoach would sell its business to PBL, whereas what we are talking about in para. 6 here seems to be whether there was a repeated offer by Stagecoach to buy PBL.

MR. THOMPSON: Yes. Sorry. That was just to clarify. I do not think there was an offer at that stage.

THE CHAIRMAN: There was no repeat of the earlier offer in 2006.

MR. THOMPSON: That is right. The reason I go to Tab 7 is that I think in a variety of contexts the Tribunal has indicated that the contemporaneous documents are of particular value in this sort of business dispute because it is difficult for people to remember exactly what happened, whereas a contemporaneous minute does tend to give the actual view of somebody at the time.

The headings are LBW ([Stagecoach Director]), then [former PBL Director], and CJB is [Stagecoach Director] (who took the minute). That is confirmed by his evidence to the Competition Commission which was signed and is to be found at Tab 9. Of course, the Tribunal will be well aware that it is a serious matter to deceive the Competition Commission and could, in principle, end up with [Stagecoach Director] in prison. So, in my submission this is particularly valuable evidence.

"LBW: Meeting held to discuss matters of mutual interest, but none which might be prejudicial to the Competition Act and fully within the parameters permissible under that Act".

So, he is obviously somewhat nervous about what might be alleged.

"[former PBL Director]: Confirmed no sale of business being considered and no call of PB to public inquiry.

LBW: Preston forms part of regular strategy review, Hence offer to consider purchase of PB in 2006. Aim of competition has never been to put PB out of business, but to expand and consolidate the SNW position. Unfortunately exaggeration of issue and pushed into the political area by PB made situation not sustainable. Both sides quite happy to co-exist peacefully. So needed an exit from current situation.

[former PBL Director]: Suggested purchase of Preston depot operation by PB ----
"

So, he is suggesting he purchases it and then [Stagecoach Director] replies,

"Not looking to sell, but everything has a price. Problem with allowing PB access to figures.

[former PBL Director]: No idea what business worth. Explained how EBT works with more than 50 percent of staff owning shares and loyalty increased as a result of the competition. LRW: The way forward was a problem. A sale of SNW Preston to PB would be likely to prompt OFT interest. So would a purchase of PB by Stagecoach. Did not wish an OFT inquiry. PB evidently not concerned. One option would be to carry on as we are. Another would be to involve the local authority in brokering a Statutory Quality Partnership promoting co-operation in matters of benefit to the industry, such as bus priorities, inter-operator ticketing, and so on. Longer term stability might prompt a re-think on strategy in due course.

[former PBL Director]: Not keen on this. No plans to sell. Wants the situation to go back to how in it was. Denies that this was an effective monopoly as asserted by Stagecoach. Confirmed age 58. Could easily retire, but no plans to do so.

[former PBL Director]: agreed the purchase of SNW not ideal, and not wanted as an operator, only as a solution.

LBW: Going back to the pre-June position creates a credibility issue. Offered further solution. SNW to sell 25 Optare Solos, services and drivers to PB. Buses valued at £[X] each. PVR, the city operation, confirmed as 28 ..."

[former PBL Director] said he was not keen on taking the staff ----"

THE CHAIRMAN: What is PVR?

MR. THOMPSON: I think it is the Passenger Vehicle Requirement. He is saying he only needed 28, but in fact it fell back to 25 in due course. Then,

"LBW: Stagecoach would not be de-registering the services, that would be for PB. Staff would retain Stagecoach conditions under TUPE. If PB wanted status quo Penwortham route would have to revert to SNW. PB to consider and respond".

In my submission, that is an important piece of evidence as to what was happening. This was the state of mind of Stagecoach on both of the key findings about, as it were, the rationality of what Stagecoach was doing and its foresight that this was bound to lead to

PBL exiting the market. In my submission this contemporary document is just completely inconsistent with really both those findings.

THE CHAIRMAN: Just remind me what you said, CJB was the note taker.

MR. THOMPSON: That is [Stagecoach Director] and his statement appears at tab 9,and he describes not only this meeting, which is not only derived from this minute but then also two other meetings culminating in a strange meeting which appears to have been at a preview for the approach to Stagecoach to buy the business – that is at tab 9, pp. 318 to 319.

THE CHAIRMAN: So this was a note made by [Stagecoach Director], of SNW.

MR. THOMPSON: Yes. It is part of our perversity and also procedural challenge that here we have a contemporary document and in effect the CC discounts it and says it cannot possibly be read at face value essentially because it does not fit into their theory of what a villainous project this was. As I say, you find that confirmed in the statement of [Stagecoach Director], and the statement of [Stagecoach Director] in tabs 9 and 10. If one then looks at Appendix F at p.126 there are descriptions of these meetings in greater detail at paras. 43 to 47.

The next topic I was going to address briefly was the question of the Traffic Commissioner, and that is a topic that exercises the CC to quite an extensive degree and one finds that, for example, at paras. 48 to 60 of appendix F at pp.127 to 130, but really, in my submission, the main point is at para. 60 there was obviously quite a lot of too-ing and fro-ing and complaints in the press and allegations backwards and forwards, there was unseemly behaviour on both sides, but at para. 60 there was reference to a public inquiry. We understand in May 2008 the Traffic Commissioner heard representations from both PBL and Stagecoach about the ongoing issues in Preston. It was the preference of the Traffic Commissioner that the operators should resolve their problems among themselves rather than through the public forum and official inquiry which was to begin on 10th June 2008. There was correspondence between the parties leading up to 10th June and at that time agreement was finalised. It was ultimately agreed that both operators would allow 20 per cent of their services to be monitored in addition to the already existing traffic regulation conditions which had proved effective at resolving the disputes that had been arising.

So, in my submission, it is all a bit of storm in a teacup and by the time at least six months before the merger took place this issue had been resolved by agreement, so in my submission it is all essentially irrelevant to the effects of the merger.

If we then look at PBL's position as it appeared in 2008 one finds that at tab 12 of the same bundle. This is the Summary of the hearing with the former management of Preston Bus

Limited held on 16th June last year, and there is a description at paragraphs 15 to 23 – I think I can take it fairly shortly:

> "15 PBL's losses increased month by month, as Stagecoach added new routes to its network. PBL lost on average some 25 per cent of passengers per week on the routes on which Stagecoach was competing. The number had climbed to 27-28 per cent at one time. Approximately 15 per cent of passengers were lost across the entire network.
>
> 16. There could have been the option of the two operators learning to live with each other; but this would not have been easy for PBL because its profit levels were not good and it had a large depot to support.
>
> 17. However, PBL did not try to scale down operations because it did not want to show any signs of weakness, which might result in a scaling up of operations by Stagecoach.
>
> 18. PBL did not make any significant change to its service frequencies: it made no change in Tanterton; put one extra bus on the Plungington Road route; one extra bus on Moor Nook; and one extra bus on Farringdon Park. Altogether it got four extra buses on its network and five vehicles on the Penwortham route. The vehicles were all hire purchase, being purchased over five years. PBL recruited 15 to 18 drivers. It also discontinued two routes it had been cross-subsidising in order to cut costs and accepted changes in conditions and employment.
>
> 19. PBL had fallen into loss within five or six months. The overall effect of this on costs was a 5 per cent increase, but the additional costs did not result in additional revenue and this took place at a time when fuel costs escalated. The situation had stabilised by Christmas 2007. Although at that time PBL Management realised they would probably have to sell the business they still hoped that Stagecoach would pull back or that the Traffic Commissioner would act.
>
> 20. The Traffic Commissioner held a very delayed hearing in June 2008. PBL was called into it with only two weeks' notice even though there were no real complaints against PBL.
>
> 21. PBL sought legal advice on going to the Office of Fair Trading, but was informed that it would be treated as the dominant competitor.
>
> 22. PBL met Stagecoach in April 2008 to try to bring the war to an end. The meeting was with [Stagecoach Director]. Stagecoach suggested selling its business to PBL for about [X] PBL considered this to be a very good offer which showed

Stagecoach's willingness to return to the pre-2007 position. However, it declined this on legal advice.

23. By the time of the public inquiry in June 2008 Stagecoach had put its fares up (while still being below those of PBL) and closed some of the routes, behaviour on the roads had improved and [X].

So in summary, by the end of 2007 PBL was already recognising that it was uneconomic, and the reason it seems to have been uneconomic is that we will have seen it had a profit of 2 per cent in advance and it raised its own costs by 5 per cent at a time when its revenues were falling and so inevitably it had turned itself from being a marginally profitable company to being a seriously unprofitable one. Obviously the point we make is that given they recognise that they were reducing their revenues it was a strange time for them to increase their costs.

THE CHAIRMAN: So when it says the situation had stabilised by Christmas 2007 you say it had stabilised by Christmas 2007, you say well it had stabilised but at a situation in which PBL was effectively loss making?

MR. THOMPSON: Well effectively it was doomed if it carried on in this strategy, but then they say at 16 and 17 that although they could have changed their strategy and lived with Stagecoach they did not want to and, in fact, they incurred additional costs, and that is really the point we make that if there was any irrationality here it was PBL's conduct rather than Stagecoach's, and there is particular reason for the CC to come in on a white horse and save PBL at this late stage.

This is the evidence of PBL itself, and it is confirmed by the contemporaneous evidence of [former PBL Director], who I think was the operations manager (and I think is still the operations manager) and one finds that in two different places: it is at tab 14 of the exhibits to the defence.

THE CHAIRMAN: I have got a memorandum from the operations director, 8th March 2008.

MR. THOMPSON: That is [former PBL Director], you will have seen a witness statement from him, but again this is a contemporaneous document, so, in my submission, it is of particular value. Its subject is "Directors' duties and responsibilities", and it is obviously Preston Business, and I will refer you to the second and third paragraphs:

"It was a unanimous board decision that the company should 'fight' the predatory actions of Stagecoach, following their service registrations in spring 2007."

So one can see what the frame of mind of PBL was, and it may have been that the Competition Commission has picked that up.

"At the time I stated that consideration should be given to reduce our high cost base given that revenue would undoubtedly affected. It was believed that Stagecoach would not 'go away' in a few months and known that a series of 'phased' new service registrations were planed. It was estimated that they would acquire between 25 – 30 per cent of the business on each route registered. The reasons for not wanting to change terms & conditions and agreements were explained and understood."

Then, if you look on the next page, in the middle – this is describing the position after November 2007, do you see that?

THE CHAIRMAN: Just wait one moment.

MR. THOMPSON: I do not know if the Tribunal just wants to read this.

THE CHAIRMAN: Yes, I think so. (After a pause) Yes.

MR. THOMPSON: I am grateful. I was going to refer the Tribunal to the second page, the middle paragraph, where it says:

"At this point ..."

This is, I think, at the New Year, or the start of 2008 –

"... it was stated that we either needed to take action to significantly reduce this weekly cost or if we believed this was not possible, to consider the sale of the company now whilst we were financially stable. It was believed as a high cost operator, there were a number of areas significant savings could be made. However, these need to be introduced as a matter of some urgency."

Then the current position is described in the last two pages. At the bottom of the page [former PBL Director] states:

"Given our financial position I strongly feel that changes are required immediately. Whilst I understand the reasons for a 'phased' approach, our situation does not allow for such an approach. The business position dictates 'a sound, good business reason' for reorganisation and new terms and conditions.

There has to be an acceptance that the number of management or supervisory positions that have the required 'skill set' for everything to be done within tight timescales is limited and we may have to consider seeking additional assistance if necessary.

It is no good doing only some of the required changes. The size of the deficit requires everything and personally I feel that continued approaching the workforce for more can be damaging. Communication is 'key' and again the more time we

have to keep re-affirming what we are doing means a drain n the limited resources we have, or worse the job not being done.

If we fell that we can't deal with these urgent issues then we must seriously consider 'selling' before the position becomes unattainable. This raises issue in itself."

Then he describes the options for sale. Then:

"I have no doubt whatsoever that some very awkward questions will be asked and we must be prepared for them. I still believe that the majority of staff would understand changes are required and wish for their destiny to be in our hands than another company."

Then he looks at his own position as a director, given the risk.

THE CHAIRMAN: On the first page of that memo, the third paragraph, it seems that their estimate of the Stagecoach plan – I do not know whether that is the plan in the first few months or whether it is the overall plan – was that they thought that Stagecoach was going to acquire 25 to 30 per cent of the business on each route registered.

MR. THOMPSON: That is broadly consistent with the rather high level figures I showed you. I think that is roughly what happened. I will be corrected if I am wrong, but I think that is roughly what happened. [Stagecoach Director] is nodding. I do not know if anybody else is in a better position, but I think, broadly speaking ----

THE CHAIRMAN: It was just a comment really that at that stage at least they did not seem to think that Stagecoach's aim was more than that.

MR. THOMPSON: No, I do not think there is any documentary evidence to suggest it. As I understand it, the Competition Commission's reasoning is that we must have known this was going to be a big hit for PBL and therefore we cannot [*inaudible*] to the 25 per cent market share. I think it is another complete non-sequitur myself, but I think that is the reasoning. There is no actual evidence that we wanted any larger market share. We bought 25 buses and there is no evidence that we ever intended to put in any more. I do not think it is alleged by the Competition Commission that there is. They just see this as some dark plot.

THE CHAIRMAN: I suppose the point is that it may well have been widely known that even that size of a chip in PBL's business would be likely to push it from profitability to unprofitability.

MR. THOMPSON: Yes, I think the point we make is that it was obviously well known within PBL, certainly by [former PBL Director], but whether we saw from the outside that PBL

was inefficient, as we saw it, I do not think there is any evidence that we knew how precarious its financial position was. I do not think it is alleged. I think it is simply assumed that we must have seen and they could not possibly survive against this level of competition. There is no suggestion in the minute that [former PBL Director] was saying, "We will not be able to survive", rather the reverse.

My next factual topic was attempts to sell PBL to third parties, and I think there are essentially two real possibilities. [former PBL Director] mentioned Transdev, but I think in reality the two offers that materialised were from Go Ahead and Arriva, and one finds that at tabs 13 and 14 of the main appeal bundle. In relation to Arriva there is a description of what Arriva's position was at paras. 5 to 10 of Tab 13. That is the summary of a hearing held with Arriva by telephone on 2nd July, 2009. It appears that Arriva hoped to buy out Stagecoach in 2008. One sees a reference about it in para. 5. They were hoping to get the whole of the Preston market. But, they then did make an offer in relation to PBL in the late summer of 2008. That is described in those paras. But, that fell through, I think because of problems in what is called the data room. There was insufficient information and there was obviously this problem over the pension deficit which ultimately was valued at about £[X] at the time of the Stagecoach acquisition.

Then in relation to Go Ahead the evidence is at paras. 3 to 7 of the next tab, Tab 14. I think what happened here was simply that Go Ahead's offer was less good than Arriva's and so it was never really pursued by anybody.

Then we come to the final stage - the sale to Stagecoach. Partly to limit the scope of any dispute between the parties as far as I can, the Tribunal will note that I have made no real reference to the witness evidence put in by [Stagecoach Director]. However, here, he is obviously in the best position to describe what happened. There is a description at paras. 65 to 72 of his statement at .243 of Tab 3 to the Notice of Appeal bundle. I do not know to what extent any of that is controversial. The gist of what he is saying is that he did not know that PBL was for sale until he was actually approached, or possibly I think he inferred that it was for sale because of a meeting he had. Then he describes how the process went through, culminating at para. 71,

> "Transactional documentation was then finalised. The acquisition completed on 23rd January, 2009".

I do not think there is anything very controversial about any of that.

I hope that is helpful. It is obviously a very brief summary of a lot of factual material that is before the Tribunal.

What I was proposing now was to hand up a single sheet of paper with ten core propositions. (Same handed) Just by way of overview, the first three are, broadly speaking, corresponding to Ground 1. 4 to 7, broadly speaking, correspond to Ground 2. 8 is fairly obviously Ground 3. 9 and 10 are Ground 4. Just to explain, this partly reflects the Competition Commission's skeleton argument where, as we understand it, Points 6 and 7, as I have put it down there, are set out as the key findings - first of all that Stagecoach (as I have a put) did not act commercially rationally during -- There may be some dispute about whether that is a fair way to put it. Secondly, that Stagecoach must have foreseen -- So, essentially the commercial reasonable of Stagecoach's conduct and the foreseeability issue -- I think the Competition Commission recognises that those are the two key factual findings. We have folded in, as it were, the reasonablenesses of PBL's response into Point 7 - because, in a sense, it is part of that point, although we have identified it as the fourth factual finding under Ground 2.

I do not know whether the Tribunal wants to ask anything now? Otherwise, I was proposing to go through these propositions and make some observations and references by reference to them.

The first one I think should be uncontroversial. I would have expected it to be uncontroversial if it was perhaps any other hearing than this one - namely, that the Competition Commission was legally required to consider the impact on competition of the creation of the relevant merger situation. That appears clearly from the Act itself. I do not know whether the Tribunal wants to look at the bundles, or whether they want to look at their purple books? It is in the authorities bundle at Tab 16. We start at s.35 on p.23. It is obviously familiar wording. Subject to some qualifications which I do not think we need to worry about,

> "The Commission shall, on a reference under s.22 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 than any market or markets in the United Kingdom for goods or services".

Obviously, the question for any lawyer would be, "What does the meaning of 'relevant merger situation has been created' -- What is the meaning of that? Is there any statutory guidance?" Of course, that is provided in Sections 23 and 26 of the Act. In particular at s.23(1)(a), "For the purposes of this part, a relevant merger situation has been created if (a)

two or more enterprises [so, here, two enterprises] have ceased to be distinct enterprises at a time, or in circumstances falling within s.24 ----"

Then there is a value threshold which I do not think we need to worry about because there is no dispute about that. Section 24 is simply about time limits. I do not think there is any need to worry about that. So, the relevant question is: Is there any guidance as to what 'enterprises ceasing to be distinct enterprises' means? You find, "Yes, there is" at p.17, s.26. There is a quite precise description at s.26. Obviously there has been a great deal of learning on these issues over the years, but, here, it is a perfectly straightforward issue.

> "For the purposes of this Part any two enterprises cease to be distinct enterprises if they are brought under common ownership or common control (whether or not the business to which either of them formerly belonged continues to be carried on under the same or different ownership or control)".

I do not think there is any need to look at the more complicated provisions of s.26(2), (3) and (4) because here I think it is straightforward that the relevant event was PBL coming under joint control with Stagecoach. Then I think I should draw the Tribunal's attention to s.29 at p.19, effectively to distinguish it from the present case. That deals with a particular situation, obtaining control by stages.

> "Where an enterprise is brought under the control of a person or a group of persons in the course of two or more transactions (in this section a 'series of transactions') to which subsection (2) applies, those transactions may, if the decision-making authority considers it appropriate, be treated for the purposes of a reference as having occurred simultaneously on the date on which the latest of them occur."

So this is a quite specific anti-avoidance provision, and so for example if Stagecoach had bought a 1 per cent share in PBL every day for 100 days then that would have been no avoidance of the application of the Act.

Then I should also refer the Tribunal to s.36, which deals with anticipated mergers. Section 36(1)(a):

> "whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation".

And so it is clear from that that it is envisaged that the creation is a specific event in time and that there will not be a gradual coming into being of a relevant merger situation where there is an anticipated merger. So if you had imagined had Stagecoach considered it appropriate, and had notified the OFT of this, it is clear the OFT would have been looking

at what actually happened on 23rd January 2009, they would not have been looking back in time to see what had been happening because that would not have been a creation of a merger situation.

By way of submission on these statutory provisions we say that both as a matter of statute and as a matter of logic and commonsense the question is: did the creation of the merger itself cause an SLC and we will come on to the counterfactual analysis in due course, but the relevant question if you are doing it in that way was what would have happened if the relevant merger situation had not been created, and that is a straight forward statutory requirement. We say it is a matter of logic and commonsense, and we have sent that out at some length, the tedious length of paras. 20 to 29 of the skeleton. But so far as the pure legal side of it is, we say this is precise statutory wording, it forms the basis for jurisdiction, and quite a powerful jurisdiction which affects the commercial rights of parties in quite a radical way so there is no reason to take a relaxed approach to jurisdiction.

We say there is no room for doubt or discretion about what this means, and the implication is that the CC must decide a specific question of fact on the balance of probabilities, and one finds that, if it requires authority, in cases such as *IBA* and *Somerfield* which I will come to in a moment. So that is the simple, statutory point.

If we then look at the soft law materials. First of all there are the terms of reference which, strictly speaking, is what the CC were operating under. We find that at the start of tab 2 of the notice of appeal bundle. It is appendix A and you will see the way the OFT put it in relation to their own finding they were exercising their duty under s.22 in relation to a completed merger, and the OFT says that it believes that it is or maybe the case that: "(a) A relevant merger situation has been created" and then it describes it, "in that":

> "(i) enterprises carried on by or under the control of Stagecoach Group Plc have ceased to be distinct from enterprises carried on by or under the control of Preston Bus Limited and;
>
> (ii) as a result, the condition specified in section 23(4) of the Act will prevail, or will prevail to a greater extent, with respect to the supply of commercial local bus services in Preston, Lancashire."

So that is the finding, as it were, on the merger situation itself, and then it continues: "(b) the creation of that situation has resulted, or may be expected to result …" Then "2" is the question that is put to the CC that they must answer the two questions set out in s.35(1) of the Act and, in my submission, it is clear and it is even more clear when one looks at the OFT's decision itself, that the OFT was operating a completely conventional approach and

was treating the creation of the relevant merger situation as being the purchase of Preston Bus by Stagecoach at the start of 2009. That is confirmed by the more detailed terms of the OFT decision, which one finds in the skeleton bundle, tab 2, this is the bundle accompanying Stagecoach's skeleton. You will see that this is the decision in the conventional form, it was published on 11 June 2009, I think it was put out on the OFT website. It describes Stagecoach, Preston Bus, it describes the transaction straightforwardly at 3:

> "On 23 January 2009, Stagecoach … acquired PBL for a consideration of £X million. As a result of the transaction, Stagecoach purchased 127 buses and a depot with a capacity for 130 buses, as well as taking on 299 employees."

Paragraph 5 sets out the jurisdiction in straight forward terms, and using the terminology of the Act:

> "On 23 January 2009 … PBL has ceased to be distinct from Stagecoach for the purpose of the Enterprise Act 2002."

Then the substance of what the OFT decided one finds at paras. 31 and 34 by reference to the counterfactual, and you will see reference in para. 34 to at the time of the acquisition, so they are clearly looking at the point at the beginning of 2009. Then the conclusions – I am taking this fairly quickly – at paras. 53 and 100. Paragraph 53 says:

> "The acquisition has therefore been assessed against the prevailing conditions of competition at the time of the merger (that is, PBL's continued operations), taking into account, where relevant, the possibility that a new operator may have acquired PBL's assts and used them to compete in Preston."

So the OFT was taking a realistic approach of saying, "What would have happened if there had not been a merger, would somebody have come along and bought PBL or PBL's assets?"

THE CHAIRMAN: Somebody other than Stagecoach?

MR. THOMPSON: Yes, "Supposing that Stagecoach had note done this, what would have happened?" You see that in more detail at 100 where they give the overall assessment in a conventional form starting with the words "Absent the merger". Then there is a straightforward analysis of what would have happened. Obviously the OFT has only got to reach a provisional view and that is at 104. Essentially, what the OFT found was that if you were to rule out the possibility that somebody else might have come and bought some assets and that might have been less anti-competitive than Stagecoach having a monopoly, and although we did not agree with that as a matter of fact we have no complaint about that as a

matter of law, and it seems to us rather an obvious and conventional approach and clearly never occurred to the OFT to address the matter in any way. It was only when the Competition Commission got hold of it that it came up with this new approach.

If we then look at the OFT and Competition Commission guidance, we have got it out in exhaustive detail in the authorities, but I think it may be more convenient just to look at the specific passages which are attached to notice of appeal bundle at tabs 26 and following. At 26 you find the OFT guidance which is in commendably short form. It is under the heading "Identification of the correct counterfactual", but I think 3.23 shows that it is really dealing with the causal issue:

> "As explained above, the core concept of the substantial lessening in the competition test is a comparison of prospects for competition with or without the merger."

So again straightforwardly.

> "The competition situation without the merger is hereafter referred to as the counterfactual.
>
> In most cases the best guide to the appropriate counterfactual will be prevailing conditions of competition. However, he OFT may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger."

So again, it is quite clear that you are looking at the causal effects of the merger and you are looking at what might have prospectively had the merger not taken place. There is no element of retrospective rewriting.

If you then turn to the next tab you will find the Competition Commission's own guidance, and I draw the Tribunal's attention in particular to para.1.19, where the Competition Commission says:

> "When the CC hindsight decided that there is a relevant merger situation it must consider ..."

so straightforwardly must consider –

> "... whether the merger results in, or may be expected to result in, and SLC (see (b) in paragraph ...). When doing so it will not be sufficient for the CC to believe that an SLC is possible: for the CC to reach an adverse decision either the merger must have resulted in an SLC or the CC must expect such a result."

So it is a straightforward causal question relating to the merger itself, and it is clear that the merger here must mean the merger referred to s.35(1)(b).

Then at 1.22 and 23 the Competition Commission says:

> "In applying the SLC test, the CC will evaluate the competitive constraints on firms with the merger compared to the situation that would have been expected to prevail without the merger ..."

then referring to that as the "counterfactual".

> "The counterfactual will be that situation which the CC expects to arise in the absence of the merger under consideration and will, in many cases, relate to the existing pre-merger, competitive conditions. However, in certain circumstances the CC may need to take account of other factors, such as expected ..."

so future –

> "... changes in the structure of the market or alternative developments that may be expected in the absence of the merger. This is in order to reflect as accurately as possible the CC's expectation of the rivalry which will occur in the absence of the merger."

So again all prospective, no element of retrospection here.

> "Therefore, the CC's focus is on the effects that the merger has on competition. Competition concerns ..."

this is very important –

> "... that do not result from the merger under consideration are outside the CC's remit in merger references."

So there is an express recognition that the Competition Commission has no jurisdiction over matters that do not result from the merger. Then it goes on:

> "They may, however, be matters which it I appropriate for the competition authorities to consider in other ways, for example in a market investigation under the Enterprise Act or in the light of the two prohibitions of the Competition Act 1998."

So the Competition Commission makes no suggestion that it is going to be taken into account in a merger assessment. What they say is, "If we find something funny going on as part of our merger analysis we might tip the wink to the OFT or we might bear it in mind in a future market investigation", but again there is absolutely no suggestion that something which is not actually the merger is any of their business, or indeed any of their jurisdiction.

Then finally at tab 31, there is a very detailed further document, which has been produced in draft by the Competition Commission and the OFT. So far as I know it is still in draft, but I will obviously be corrected if it has been finalised. I would refer the Tribunal in particular

to para.4.9, where it is expressed in terms of the fashionable concept of the "theories of harm", and it says:

> "The theories of harm trace the logical steps between the merger, the loss of rivalry and expected harm to customers compared with a situation likely to arise if the merger did not take place."

So that is a slightly more technical account of the counterfactual.

> "Identifying the counterfactual is central to the authorities' overall assessment of a merger since the core concept of an SLC is the lessening of competition caused by the merger when compared with what would have happened ..."

So the future, you are looking again –

> "... had the merger not taken place."

Then there is a description of the counterfactual at 4.16, and again I refer the Tribunal, without wearying you too much by the reference to the comparison of the competition with the merger against the competition situation without the merger, so it is a straightforward factual comparison.

Then I think paras.4.24 and 4.25 are worth looking at. 4.23 says that there is a presumption in favour of the status quo as the appropriate counterfactual. Then it goes on:

> "However, this is presumption may be rebutted – either by evidence that a realistic alternative counterfactual that the OFT considers (given its statutory test) it should take into account in its analysis, or by evidence from the merger parties on the appropriate counterfactual ..."

Then it goes on:

> "This means in a situation where the merger firms are both active in a market at the time of the merger and the counterfactual consideration is whether is whether one of them would have existed from the market had the merger not gone ahead, the OFT would require compelling evidence that such exit was 'likely and imminent' so as to rebut the presumption that the party in question would have remained to compete in the market."

That reads in rather bizarre terms in the present context because here there was evidence that PBL would probably have exited the market and OFT accepted that and I think the Competition Commission probably accepted that. The question of whether or not there was sufficient evidence for the failing firm defence to succeed is perhaps in doubt, but oddly here the Competition Commission in effect assumes that Stagecoach would have exited the market without any evidence that that was the case, but it assesses the competition situation

on the basis that it is to be compared with a situation without Stagecoach on the market. We would say that that is entirely upside down and back to front from the approach that would be adopted here, where you are normally looking at whether the weaker firm would have left anyway. What the Competition Commission finds is that the stronger firm would for seem to me reason have disappeared from this market, and PBL, which was about to fail, would have been reinstated in a monopoly position, and that is the counterfactual that they used. We say that is totally unprecedented and inconsistent with the guidance.

Then 4.25 describes how the Competition Commission operates itself.

> "[The CC] will consider the most likely outcome in the market under investigation and define the counterfactual based upon its expectation. [So, again, future looking] This may often, but not always, be the prevailing conditions of competition. At both Phase 1 and Phase 2, known third party events in the near future (including competitors' expansion plans and planned regulatory and legislative changes affecting the industry) will be included in the consideration of the counter factual. No counterfactual can be constructed that involves existing agreements in violation of competition law, e.g. on cartels".

That last sentence is quite important because it is relied on by the Competition Commission at para. 26 of their skeleton. They are saying that if it is okay to exclude consideration of cartels, then why is it not okay to exclude the period of abnormal competition. I do not know whether it would help to look at that, but that is essentially what they say.

Our submission on that is that what is being said here is that it is perfectly reasonable for the Competition Commission or, indeed, the OFT to assume that if a cartel is operating in the market, then the OFT will come along and put an end to it, and it would be unrealistic to assume that there is no competition because there is a cartel which the OFT could deal with. But, I do not think it necessarily follows that all cartels would be ruled out. For example, if there was an oil merger, I do not think you would necessarily ignore the existence of OPEC in deciding the effects of a merger. Likewise, for example, if there was evidence of state aid being given to a French company and that was affecting the merger, I do not think you would necessarily exclude that. With respect, I would treat this last sentence as a pretty narrow exception that anti-competitive conduct which is within the remit of the OFT, it may be appropriate to exclude, but otherwise what all this guidance is saying is that the Competition Commission, the OFT are looking towards the future and trying to assess in a realistic way what would have happened if this merger had not taken place. So, that is what

we say we get out of the guidance. I will obviously come back to the last sentence of 425 if Mr. Unterhalter makes a great play of it in his submissions.

Turning to the case law, I do not think it is necessary to go into any great detail about the case law because I think the point has always been taken for granted. I think it is part of our sense of grievance in this case is that the approach is that the Competition Commission really has no precedent and nobody has ever really even thought of this as a possibility. But, insofar as one needs authority one finds it in the judgments in the Court of Appeal and the Tribunal in the *BSkyB* case, which is obviously very recent. I think I can go straight to the relevant paragraphs because the facts of *BSkyB* are probably reasonably well-known and they are fairly remote from the present facts. It was essentially about a minority share of BSkyB in ITV. We find that at Tab 3 of the authorities bundle. One can go straight to the dicta of Lord Justice Lloyd at para. 43.

> "A counterfactual is the hypothesis as regards the facts by reference to which an alleged effect on competition is to be tested. In essence, it involves considering what would have happened in other circumstances, in the present case if the Acquisition had not taken place ----"

Obviously there is a capital A there, but I think it is a statement of general principle. In our case it would be our acquisition rather than the acquisition in that case. Then, at para. 54 the Court of Appeal cites the judgment of the Tribunal with approval. One sees that at para. 55. The relevant paragraph, I think, is para. 91 of the Tribunal's judgment.

> "The Tribunal rejected the arguments of Sky. The identification of a counterfactual does not mean the possible changes in the market cannot be considered in the assessment of SLC. The identification of the counterfactual does not ossify the SLC analysis. Indeed, Mr. Flynn QC who also appeared for Sky rightly accepted the counterfactual could not be 'pinned to a board like a butterfly at an earlier part of the Commission's assessment, it actually remains alive, vibrant and important throughout' the substantive analysis. As already noted, 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 took used to assist in answering the question posed by s.47 [well, here, s.35 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 of intensity of competition without the merger".

So, again, it is a straightforward analysis and insofar as it is necessary the same appears from the Tribunal judgment itself which is at the previous tab. We have looked at para. 91, but a similar point is made at paras. 85 and 86.

THE CHAIRMAN: I do not think we need to go to that.

MR. THOMPSON: I simply give the reference there. We would say that the consistent usage has been the value of the counterfactual, to assist a prospective analysis -- a realistic analysis looking towards the future of what would have been likely to happen in the future in the absence of the creation of the RMS. The Competition Commission is required to consider what would have happened and, in this case, had Stagecoach's acquisition not proceeded, not to reach a judgment of policy, in effect, on the implications of past acts or past competition. In this respect, para. 43 of the Competition Commission's skeleton which makes reference to past factual events -- We say that that has no basis in either the statute or the guidance - except, of course, insofar as a guide as to what realistically might have happened in the future. You could look at the past for that purpose. That is clearly not the purpose for which the Competition Commission is looking at the past events here. There is no suggestion that because Stagecoach did this or that, that it would not have done this or that in the future. It is all looking to the past.

That is what we wanted to say by way of submission on Proposition 1.

The second one, I hope, is pretty straightforward. The merger was created on 23rd January, 2009 when Stagecoach and PBL ceased to be distinct enterprises. I have shown you the OFT finding at para. 5 of their Decision and their terms of reference at Tab 2 of the Notice of Application for Review bundle. For what it is worth, the Competition Commission appears to agree on this point. One find that - and I do not know if we need to turn it up at paras. 3.1 to 3.2 and 3.9 to 3.10 of the Decision. We say that that straightforwardly flows from the terms of the Act (Sections 23, 26, 35, and 36) and in distinction to Section 29.

The only further point I think I need to make about this is that there seems to be some sliding around by the Competition Commission in their skeleton argument at paras. 52 to 55 where they seem at least to flirt with a new argument about the meaning of creation. One sees that from para. 52 of the skeleton where they take issue with our rather straightforward -- Page 17, para. 50 and following, but in particular para. 52 and following. There is a short of crescendo in that at para. 50 there is a quotation of s.35, and then at 51 you will see the word "creation" is underlined, and then at 52, "creation of" is underlined, and then at 53

"*creation of*" is italicised, so I am not sure whether there is any significance in adding the words "the" and "of". However the gist of it is that creation is meant to be an interpretative guide, you will see at the end of 53, which is the possibility of considering the wider context in which the merger arose. Then 54 and 55 says that this:

> "… would include the circumstances surrounding the RMS the context in which it took place and the factors that led up to it. This is exactly the approach the CC took in the present case."

Then the approach to s.35(2)(b):

> "is both textually correct and it is sensible given the purpose of the legislation. Such an approach situates the merger in its economic context."

I do not really know what to say about this. It is obviously wrong because it does not reflect the wording of the statute, and it just seems to be a new, rather desperate argument trying to broaden the scope of s.35(1)(b). It is quite clear what s.35(1)(b) means, because it refers back to 35(1)(a), which in turn refers back to s.23(1) which in turn refers forward to s.26(1) and is in distinction to s.29. So there just is no room for this sort of expansive approach, and I do not think there is any hint of this point in the decision, or in the defence, and in my submission it is a submission that probably would have been better not made, because it is simply wrong. That is all I was going to say about proposition 2. Proposition 3 really takes one to the heart of it, which is that the CC was not legally entitled to consider the impact on competition at the period of direct competition between Stagecoach and PBL on 24th June 2007, and we have already seen in the guidance document where the CC itself effectively says that. I have also already made the point that there is clearly jurisdiction for this type of investigation under s.s2, 18 and 25 of the Competition Act 1998 where the jurisdiction is conferred specifically on the OFT and, of course, there is also jurisdiction in the High Court to consider such an issue, and we added an authority, I do not know if it got through to the Tribunal where the High Court did consider such an issue in a very similar context, that is the *Chester City* case, and I think it might be worth just looking at it very briefly.

THE CHAIRMAN: Well I am not sure this is contentious is it? Mr. Unterhalter, are you claiming that you have some jurisdiction in the merger context to take action or investigate breaches of these other statutory provisions.

MR. UNTERHALTER: No, not at all, as we will explain in our submission.

THE CHAIRMAN: Well let see how Mr. Unterhalter puts his case before we need to go to that.

MR. THOMPSON: I am grateful for that indication both from Mr. Unterhalter and the Tribunal. The reason I mention it is because there were, as it were, two impediments to the CC

getting involved here, one – if I put it crudely – it is not the OFT or indeed the High Court; secondly, as Mr. Justice Rimer found in the *Chester City* case there is of course a threshold jurisdictional issue even for the OFT, namely the question of dominance, and in the *Chester City* case in rather similar facts to the present one allegations were made of abusive conduct by a bus company, in that case Arriva, and Mr. Justice Rimer dealt with effectively issues that appear in Appendix G to this decision in short form saying that if Arriva was not dominant then no question of abuse arose, and by parity of reasoning really the points that the CC treated as abnormal would even be irrelevant for the OFT and so we take that point against the CC as a matter of substance, and you will have seen it in our original notice of appeal at around para. 50.

We have looked at the market shares of PBL and Stagecoach and we have looked at sections 29 and 35 of the 2002 Act. We say that the CC's powers under s.35(3) in particular are extensive and that they must be construed strictly to ensure that the CC does not act outside its jurisdiction and we say as a matter of substance that the CC clearly did assess the impact on competition of the period of direct competition from June 2007 and that it based its SLC analysis on this assessment, and that this error vitiated that analysis and undermines the legal basis for that finding, and for its proposed remedy. The Tribunal will no doubt have seen the relevant passages, they are referred to in our submissions and also they are key parts of the decision, but just for your note, as it were, I refer in particular to appendices H and J to the decision and I think it is sufficient to look at para. 1 to see what the CC was up to in appendix J, because the Tribunal will appreciate that this the substance of the analysis that was done in relation to the issue of SLC as reflected in part 8 of the decision. The CC says:

> "The type of harm that could have ensued following the merger will depend on our choice of counterfactual."

So they recognise that fact.

> "As we explained in Section 6 of the report, we found that the correct counterfactual is the period before the abnormal competition between Stagecoach and PBL, that is before June 2007. Under this counterfactual, the relevant competitive constraint posed by Stagecoach on PBL and vice versa during the period following June 2007 is not relevant. We therefore need to focus on the type of competitive constraint, if any, that existed between the parties before June 2007."

So it is quite clear that what they are doing here is that the causal analysis is based on the period of abnormal competition and the counterfactual, which is, as it were, the mirror image is based on taking out that entire period and not simply taking out the merger, that is quite clear on the face that that is what they were doing, they were looking ----

THE CHAIRMAN: What they were saying was: "Looking ahead as we are required to do, what do we think will happen in the absence of the merger? They rule out in Appendix H it being possible, probable, whatever, that Stagecoach would have picked up the assets when PBL failed, they say it is not necessarily what would have happened, but the question they have to ask themselves is "Looking at what happened just before the merger, do we think that would have continued in the absence of the merger for one, two, or whatever number of years? Or do we think that in the absence of the merger things would have settled back down to where they were before June 2007?" They say: "We think what happened before the merger was 'abnormal' they called it, so we do not think that would have continued. What would have happened was that things would have settled back to where they were", and where they were was there were two competitors, and now there is only one.

MR. THOMPSON: Well, with respect, they take a more technical approach and that in accordance with their guidance. They say: "In order to assess the causal issue we will identify the counterfactual." Here, the counterfactual is to take out not just the merger, but to take out the entire period of normal competition", that is what they do. So what they are looking at here is the causal effect of the period of competition, that is, as it were, the counterpoint and the purpose of the counterfactual analysis.

THE CHAIRMAN: Well that is the jump I am not quite sure I see. Are they not saying that because the period of competition before the merger was abnormal, it was not likely to continue and therefore it is not the proper counterfactual, the proper counterfactual is what happened before that.

MR. THOMPSON: That is the alternative way I was putting my introductory remarks, that in that case – they do not say this, but they would have to make a finding that Stagecoach would have exited the market immediately the acquisition had gone ahead, made a positive finding to that effect. They do not even make that finding. What possible reason would they have when PBL was about to fail? I think they accept that in Appendix H. What possible reason would there have been to find that Stagecoach at that point would have exited the market. I think it is accepted that there was no regulatory prevention of Stagecoach remaining on the market. Stagecoach had bought it buses, it had invested. PBL had come cap in hand saying, "Will you buy us, please?" and then the Competition Commission, on this

hypothesis, which is not what was done in the decision, would have made a positive finding that for some reason at that point Stagecoach would have picked up its bags and gone home. That is not even found in the decision. We would have an objection to that legally, but factually it would be a ridiculous finding and it is not even made.

THE CHAIRMAN: Is it not Stagecoach's case that all they ever wanted was 25 per cent of the market in order to fill up their own depot?

MR. THOMPSON: But is it suggested that had the merger not gone ahead Stagecoach would have gone home? There is no evidence to that effect from anybody.

THE CHAIRMAN: I think it is suggested that they would have settled back down, things would have settled back down, either to what they were before June 2007 or perhaps at a slightly larger share of the intra-urban bus routes, but still two competitors in the market.

MR. THOMPSON: In my submission, that just is not what was found in the decision. What was found was that the counterfactual was the entry had never taken place, and they were comparing a position as at 2007.

THE CHAIRMAN: That is one of the issues between you, is it not, as to what the key critical finding is. You interpret it as being that you would never have entered. They say, "No, we did not have to find that, what we had to find was that if the merger had not taken place there would still have been two, you and PBL – whether PBL was in under new management or new ownership – in the market.

PROFESSOR BAIN: I have a related difficulty, Mr. Thompson. I find it difficult to see this as a legal point, as opposed to a point of substance about the particular finding. Surely, if the counterfactual is an analytical structure, the Competition Commission are entitled to approach how they determine that in whatever way they think fit. That is what they have done. It seems to me that what you are saying is that they have not taken account of all the relevant evidence. I do not see that as a legal point, I see that a point of really your ground two, rather than ground one, although the two are, to some degree, intermingled. I find it difficult to see that there is anything in the Act that prevents them saying, "In our judgment, the best counterfactual is the situation prior to the summer of 2007". You can challenge it, you may say that it is not supported by the evidence. That is ground two. But it is not a legal point that they are not entitled, as I see it, to use whatever evidence they think fit to produce the counterfactual. It is a difference between law and the substance ----

MR. THOMPSON: If that had been what they had done, I agree, but when you look at Appendix J, page 1 the correct counterfactual is the period before the abnormal competition between Stagecoach and PBL. That is before June 2007.

PROFESSOR BAIN: Yes.

MR. THOMPSON: The causal question and the counterfactual question are interlocked. The wider the counterfactual the wider the causal issue. What they have done is broaden the counterfactual way beyond the scope of the merger and looked at the position of the period of abnormal competition – what has happened as a result of that? They have said the period of abnormal competition has resulted in SLC, and it is quite clearly the star to the defence, and that is exactly the purple prose, that "before the 2007 bids Stagecoach did all this, and as a result of all that conduct there was an SLC".

THE CHAIRMAN: That is how you have interpreted the decision. They say that is not the correct interpretation of it. They say, "All we have done is decided that, looking ahead, as we are required to do, what situation would have obtained absent the merger? We find it would not have been a failing firm, or we are not convinced it would have been a failing firm. PBL in some shape or form would have continued to exist, and that what was going on before the merger, the period of abnormal competition, would not have continued to persist."

MR. THOMPSON: They found more than that, with respect, they have not tried to come up with a realistic analysis of what would have been left of PBL and what Stagecoach would have done. They have rolled the thing right back to 2007. That is not simply a questionable analysis of what would have happened on 24th January if the agreement had not been signed, it is a completely different exercise. It is what was the position in the golden period before June 2007, and we are going to compare that with the position as a result of the merger. It is not a comparison between the position on 24th January 2009 without the merger and the position on 23rd January 2009 with the merger, it is the position of the competitive situation on 23rd June 2009 with the position in June 2007, and it is quite explicit. There it is at Appendix J, page 1, and I can give you any number of examples.

THE CHAIRMAN: What do you say is the correct counterfactual then, that Stagecoach would inevitably have acquired PBL's depot and buses?

MR. THOMPSON: It would have been overwhelmingly the most likely outcome. I think, if you look at Appendix H, the Tribunal has put it to me that there were some positive findings against the failing firm defence, but, in fact, that is not right, with respect, because this is not the OFT and the Competition Commission has to make up its mind. The furthest they go is at Appendix H, para.42. You will see at para.40:

> "... possible that a retrenchment of services would ensue.

41 ... we could not establish with certainty that an agreed solution for the pension scheme deficit could be reached.

42 The uncertainties resulting from the state of capital markets in autumn 2008, the uncertain outcome of the interactions between the vendors, the bidders, the pension fund and PCC that would have continued throughout the negotiations and, above all, the uncertainties relating to Stagecoach's own competitive behaviour during that time prevent us from concluding whether a trade sale or administration was more likely. However, even if PBL ..."

THE CHAIRMAN: Sorry, what page are you reading from?

MR. THOMPSON: This is the end of Appendix H, p.164 to 165.

"However, 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 business services in Preston as it now has a result of the merger."

That is not good enough, in my submission, for ----

THE CHAIRMAN: You have not challenged the finding, the rejection of the failing firm defence.

MR. THOMPSON: There is no finding on that issue. There was a finding in the provisional, but it was deliberately taken out. One sees that from ----

THE CHAIRMAN: Where is Appendix H dealt with in the decision?

MR. THOMPSON: Appendix H is referred to section 6, p.34, para.6.2.

THE CHAIRMAN: They say:

"... we do not consider that this is an appropriate basis for the counterfactual analysis."

MR. THOMPSON: Yes, so it was never relied on. There was no alternative. As I have just shown the Tribunal, no conclusion was reached in relation to Appendix H. They made some doubtful remarks, but they certainly did not make a finding of an SLC on the basis of the position as at January 2009. Precisely not.

PROFESSOR BAIN: I think I may be one behind the other members of the Tribunal. Is your attack on their analysis of s.35 that they misconstrued creation or that they misconstrued SLC?

MR. THOMPSON: I do not think it is either of those things, but that the Act itself requires the causal analysis to be based on the creation of the relevant merger situation. That is clear from s.35(1)(b). So, it has got a narrow focus. You have got to look at what was the causal effect of the creation of the SLC. Here it was common ground until then - subject to the shifting around in the skeleton argument - that the creation of the SLC was a specific event, namely the acquisition of PBL on 23rd January, 2009 ----

THE CHAIRMAN: The relevant merger situation.

MR. THOMPSON: Sorry. I have my acronyms muddled up. The approach of the OFT was indeed to look at what would have happened if that specific event had not taken place, and their concern was that the assets might have been able to be bought by someone more competitively than Stagecoach. Appendix H to the Decision looks at that issue, but reaches no conclusions. It simply says, "We cannot exclude the possibility that --" which is not good enough for the purposes of a s.35(1)(b) finding which has got to be to decide the issue. We will see how the *IBA* case puts it. They have got to reach a conclusion on that, and they do not reach any conclusion on that. What they reach a conclusion on is a different question and the wrong counterfactual, and the wrong causal question - namely, that the conduct of Stagecoach from June 2007 through to 23rd January, 2009 -- The position was less competitive on 23rd January, 2009 than it had been in June 2007. That is to expand the counterfactual in an impermissible way by lifting out an entire period of competition which had nothing to do with the merger and to expand the causal analysis in a way which the Act simply does not provide for. There is no provision for the Competition Commission to look at historical competition between parties in assessing whether there is an SLC. That is the legal point. We say that it is quite clear that 6.2 says that the position in September 2008 - which I take to be equivalent to the position in January 2009 - is not the appropriate basis for the counterfactual analysis. So, they are rejecting the conventional approach of the OFT. They then quote the counterfactual analysis in the their own guidance which repeatedly refers to 'without the merger expected changes, expected in the absence of the merger', but then they look at historical events. They say, "We also 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".

Then they look at the position in relation to Stagecoach's conduct in the eighteen months that preceded the merger and then at 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.

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".

It is that para. 6.6 that is incoherent in that they start in one place and they finish in another, and the two are unrelated to one another. So, although formally the last few words mirror the imposition under s.35(1)(b), the initial words refer to a completely different thing. They refer to a period eighteen months before the merger and prior to competitive conduct which the Competition Commission accept is outside their jurisdiction.

PROFESSOR BAIN: So, their mistake is neither creation, nor SLC, but they did not decide the following questions, in a nutshell.

MR. THOMPSON: Yes. In the Book of Common Prayer, they did that thing which they ought not to have done, and they failed to do the thing that they ought to have done. They never reached a conclusion in Appendix H, and the conclusion they reached was on the wrong question.

PROFESSOR BAIN: You say that even though the counterfactual is not a legal thing, but only an aid to thinking.

MR. THOMPSON: Yes because s.35(1)(b) is a legal thing and the Court of Appeal and the CAT, and the OFT in this case, and all the guidance have all said that in order to work out whether the creation of the relevant merger situation caused, or resulted in, a significant reduction in competition. It is appropriate to look at what would have happened if the merger had not been created, and, in this case, what would have happened if Stagecoach had not taken over PBL on 23rd January, 2009. That falls out quite straightforwardly. But, if you take a counterfactual of the position from June 2007 through to January 2009, then if you apply it to the statutory wording you have to put the same thing in and you say a period of competition from June 2007 to January 2009 caused an SLC. That is the wrong legal test. That is the point. The counterfactual is simply the converse of the statutory wording. If you put that counterfactual into the statutory wording you will go way outside the jurisdiction of the Competition Commission. It had no jurisdiction to look at the period of competition from June 2007 to January, 2009. Indeed, it recognises that in its own guidance.

THE CHAIRMAN: What do you say should have been the counterfactual then? Without the merger what would have been the position on, not 24th January 2009 (because I think they have to look a little beyond that), but during the course of 2009/2010?

MR. THOMPSON: There would have had to have been a realistic appraisal of what would have happened on this particular market in the light of the conditions that were prevailing at the end of 2008/beginning of 2009. I think it was pretty much common ground that PBL had been hopelessly unprofitable, on [former PBL Director]'s evidence, for over a year. He was worried about his director's duties even in March 2008. PBL would have almost certainly have failed, and certainly on the balance of probabilities PBL would have failed. Then the question would be whether Stagecoach, which had a depot on the edge of Preston, and which already had some buses on the market, would have been in a very good position to register the routes (as I think Arriva did in the Chester City case) -- Whether the reality is that Stagecoach would have stepped in, registered the routes, bought the buses it wanted and if it did not want the buses, would have brought in its own buses, or whether somebody else would have come into the Preston market and bought at least some of the routes. The obvious analysis, which is what the OFT undertook, was: Was there a sufficient prospect of somebody else coming into this market in competition with Stagecoach for the monopoly to be of concern, or was the realistic position that nobody was going to come into this market in competition with Stagecoach, given its advantages, and therefore there was no SLC resulting from the merger. In my submission, it is absolutely plain as a pike staff that that is what the CC should have done; the whole analysis is a complete nonsense as far as I can see. That is obviously what they should have done and that is what the OFT did. The problem with any alternative, and the CC saying: "Yes, we really did do that" is when you look at Appendix H that is not what they did, they made some doubtful remarks, but they did not reach any conclusion under Appendix H.

PROFESSOR BAIN: So your legal point is the absence of finding in Appendix H that there was a realistic prospect of somebody else coming in from the market or there being some other solution in which Stagecoach would have had a smaller market share than they had in the merger, absent that finding they were getting into legal trouble, is that right?

MR. THOMPSON: Well there are two points. They failed to make any finding under appendix H and they would have trouble under the remedy anyway because it would have been a quite different form of concern, if it had been based on not quite accepting the failing firm defence, the whole analysis would have been quite different and that is not what they did, they cannot fall back on to that.

PROFESSOR BAIN: As I read paragraph 42 of Appendix H, the last paragraph we have been looking at, what they are saying there is that they cannot rule out the possibility that there would have been some solution against Stagecoach, the smaller share of the market, than they have as a result of the merger.

MR. THOMPSON: Exactly.

PROFESSOR BAIN: They do not go as far as to say that: "We find that there is a reasonable prospect of that", they say they cannot rule it out but they do not go quite so far as to say: "We find that there is a reasonable prospect of that", because as I read the draft guidelines, if they found that there was a reasonable prospect of a less monopolistic solution than Stagecoach having the whole market then they would be entitled to find that there was SLC, that is looking at the draft guidelines.

MR. THOMPSON: There is authority from the Court of Appeal on this, which is that it has to be a balance of probabilities finding that this is what would have happened, and it is clear that they did ----

PROFESSOR BAIN: They clearly did not make a statement of that kind in the relevant document.

MR. THOMPSON: They deliberately drew back from any Appendix H failing firm analysis, and said "No, we're going to put all our eggs in the ----"

THE CHAIRMAN: Well except in the body of the decision, if you look at para. 6 – it may be that this is something that we should wait to hear what Mr. Unterhalter has to say – but at paras. 6.2 and 6.4 they do seem to be saying that they are rejecting the failing firm defence. Stagecoach in 6.1 is putting forward exactly what you have just said that the counterfactual is PBL would have failed, nobody else really would have been interested apart from Stagecoach and it is likely that either would have exited the market completely, or would have been brought up by Stagecoach, that is really what you are saying in what is recorded as your submission. Then they say they do not consider that that is right, if you look at 6.4:

> "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 have inevitably have ended up with its current high share of the market for bus services in Preston."

So if they reject that the counterfactual must involve two operators in the Preston market with some share between them either going back to 2007 levels or some other division of the intra-urban traffic.

MR. THOMPSON: I think there might be a slight misunderstanding here, this is section about what the correct counterfactual is, and the reasoning here is that they do not accept that the Appendix H counterfactual is the right counterfactual and you see that from 6.5: "The appropriate starting point for the assessment of the counterfactual is therefore the period going back to 2007". So they expressly say we are not going to make a finding on the Stagecoach basis so that is not the right counterfactual.

THE CHAIRMAN: So you interpret this ----

MR. THOMPSON: If it were the right counterfactual then you have to look in Appendix H as to what they found, and they have not made any finding.

THE CHAIRMAN: I see, so you interpret section 6.1 to 6.6 as saying "This is what Stagecoach say was the counterfactual, but we do not decide that because we think the best thing to do is to go back to 2007 ----"

MR. THOMPSON: Yes.

THE CHAIRMAN: "-- and ignore the period of abnormal competition".

MR. THOMPSON: You see that when you get to where they do actually assess the SLC issue in s.8. They are not considering the competitive effects of the failing firm at all at that point, they have gone off on their other topic, which is the effects of the merger should be measured against the level of competition similar to that which existed prior to Stagecoach's launch of its network of intra-urban services in summer 2007.

In the decision, that is what I would call, with respect to JK Rowling, the "time turner" approach where you go back in time to 2007 and look at what would have happened if there had been no abnormal competition, but I think what is being put to me is: "Oh no, maybe it was a prospective analysis", but if you do that then you are assuming that for some reason Stagecoach would have suddenly left the market in January 2009 and that is not even a finding in the decision. The finding that is made is that they compare the counterfactual with the position in 2007 and so the causal analysis is based on the period of abnormal competition and not the effect of the merger. They deliberately avoid any fallback to Appendix H.

For what it is worth I think perhaps in conclusion we should look at 8.31(a) which again makes it clear on p.47 of the decision. So there first finding makes no mention to the merger, it says:

> "Before June 2007, PBL was constrained by Stagecoach in the form of both actual and potential competition. The nature of the potential competition changed in the period after July 2006 when Stagecoach became an 'actual potential competitor'

as opposed to a 'perceived potential competitor' that it had been in the period before July 2006. the nature of actual competition remained broadly the same throughout the period before June 2007."

That is their first finding, so it is quite clear that they are basing it on an historic analysis, there is not even any reference to it before the merger. Then in 8.32 they say: "The merger has eliminated …" but the analysis is actually the position since June 2007. So although they have used the word the "merger" in 8.32 and in 9.1 it is clear from 8.31(a) that the analysis is actually based on the effect of the period of abnormal competition.

Then as a matter of law we say this is not an area where the CC enjoys any wide discretion and I will obviously come back to that in relation to the issue of fact, and unless there is anything else one wants to discuss in relation to ground 1, I think I will move forward on to ground 2 which I think, Professor Bain is suggesting is of interest to him.

THE CHAIRMAN: Well what we were also considering was whether that would be a good place to break for the short adjournment and come back at 10 to 2.

MR. THOMPSON: Yes, I am happy to do that.

THE CHAIRMAN: Unless you have some preliminary remarks on ground 2.

MR. THOMPSON: No, subject to guidance from the Tribunal it has obviously been dealt with in some detail in the pleadings and the submissions, and obviously I will deal with the points that I want to deal with but I was not proposing to deal with every factual point at enormous length. I do not know what the Tribunal wants in that respect.

THE CHAIRMAN: Is it in relation to the second ground that the note you sent up yesterday about third party evidence is relevant?

MR. THOMPSON: Well, it is an important element in that in that one of the reasons why I think the Competition Commission found this to be in some way abnormal is that it was out of line with the views of third parties. Is the Tribunal thinking that maybe we could look at that now or at 1.50?

THE CHAIRMAN: I do not want to take you out of the order in which you were planning to do things so why do we not break now and come back at 1.50 and we can decide then whether it would be best to have the first part of this afternoon's session in Camera, if that was convenient, or whether we will then come to that stage at some point later in the afternoon.

MR. THOMPSON: Yes, I am not sure who needs to be out of the court. Clearly my two lay clients need to be out, but I am not sure about who else is, as it were, on the inside from the Competition Commission's point of view. I would imagine it is fairly straightforward either way.

THE CHAIRMAN: Thank you. We will come back at 1.50.

(Adjourned for a short time)

THE CHAIRMAN: Mr. Thompson, you asked, before we rose for the short adjournment, to what extent we wanted you to go through the detail on the Ground 2. I think what we can say is that what we are interested in, particularly at the moment, and this is without having formed any views as to any aspects of it at present, is that if the Competition Commission's case is that they properly chose as a counterfactual the period before June 2007, whether it is your case that there was no evidence on which they could properly rely to establish that the most likely way the market would have developed in the absence of the merger was that things would revert to the 2007 balance as between Stagecoach and PBL, or to something similar to that balance.

MR. THOMPSON: I am grateful. I think to some extent it goes back to some of the issues we were discussing before the short adjournment in that we would say that there is nothing in the Decision to suggest that that was actually what the Competition Commission was even trying to do.

THE CHAIRMAN: No. I understand that.

MR. THOMPSON: I will certainly bear that in mind as I go on. If I could just pick up the points from before the short adjournment. If we look first of all in Appendix H at para. 12, p.160, pt H3 of Tab 2, there is a description of PBL's management accounts - although the detail has been deleted, presumably on grounds of confidentiality. Then it says,

> "This suggests that PBL would have been able to continue for a further few months. However, given the continuing competition with Stagecoach it is unlikely that PBL's losses and cash outlays would have lessened significantly during the later months of 2008. We would therefore think that it was likely that PBL would eventually have been unable to meet its financial obligations".

That appears to be a positive finding of two things: (1) that Stagecoach would have stayed on the market and that in the face of it PBL would have at least been unable to meet its financial obligations. I think that effectively means that it would have been driven out. So, it is precisely for this sort of reason that we think it was perverse to take a counterfactual that Stagecoach would have exited the market and PBL would have returned to its heyday of June 2007. So, factually, as we will come on to, we think it was a bizarre finding to reach. But, the point we were making before the short adjournment is that legally the approach of the Competition Commission was not even to look at the position realistically as what would have happened in January 2009, but simply to leap back in time to June 2007

and say how nice things had been in those days, and to compare that to the impact of the merger, and that that was not a proper approach at all.

If I just wrap up my submission - I have certainly made it in writing and I may have made it before - we say that s.35(1)(b) requires the Competition Commission to answer a causal question which is: Did, on these facts, the creation of the relevant merger situation on 23rd January, 2009 result in an SLC? The counterfactual equivalent of that is: What would have happened in the absence of the creation of the relevant merger situation on 23rd January, 2009? The question under s.35(1)(b) was not: Did the period of 'abnormal competition' result in an SLC and therefore the counterfactual based on what would have happened in the absence of a period of abnormal competition is not legally permissible and did not enable the Competition Commission to answer the legal question that it was required to answer by s.35(1)(b). I think that is about as clear as I can put our case.

THE CHAIRMAN: Thank you.

MR. THOMPSON: If we then go on to the facts, Propositions 4 and 5 -- I have tried to, as it were, come at the key factual issue from two angles: (1) as a matter of principle and (2) as a matter of fact. I was saying that it was perverse. The first one says that they acted perversely and irrationally in finding that the impact of the merger created on 23rd January, 2009 could and should be assessed by reference to competition between independent undertakings occurring over the previous eighteen months. So, we say that factually, as a matter of principle, that was the wrong way to look at it. Then, if you look at what the actual findings were, we say that the Competition Commission acted perversely and irrationally in finding that in the absence of a merger created on 23rd January, 2009 the entire chain of events from 24th June, 2007 would have been different from what it was. So, that is part of the sort of perversity, and similar to the legal point.

Then, the second point - and I do not think this is the way it is put in the Decision at all, but it appears to be part of the way it is defended, and it is what we have discussed this morning Stagecoach would have exited the market so that PBL's monopoly would have been reinstated. I do not think that is even a finding in the decision. But, if it were, we would say it was perverse as a matter of fact. There is simply nothing to support it.

If I then go into that in a little bit more detail -- We say that it is clear that this is the way the Competition Commission did look at it - not only from the Decision (which to some extent we have looked at already), but also if one looks at the defence it is equally clear from that, and in particular from the introductory salvo at paras. 1 to 10 -- You see at para. 3,

> "The Competition Commission found that PBL and Stagecoach provided nearly all local commercial bus services within and around Preston. Before June 2007 PBL focused upon intra-urban routes while Stagecoach served inter-urban routes, but central to the assessment of the Competition Commission is the finding that the only significant rivalry in the relevant market took place between Stagecoach and PBL".

So, clearly they are focusing on June 2007. Then they summarise it.

> "Although the constraints that Stagecoach and PBL each applied to the other were not the same as to kind or degree, the net result was significant competition between the two companies in the relevant market".

Then they go on to say what happened. At para. 8,

> "The Competition Commission considered Stagecoach's expansion of intra-urban services and what followed to constitute abnormal competition inter alia because it was extensive, heavily loss-making and unsustainable and significantly weakened PBL. Stagecoach's actions secured the conditions under which the acquisition of PBL by Stagecoach took place. Its actions were instrumental in bringing about the SLC identified by the Competition Commission, forcing the sale of PBL".

So, it is clear that what they are looking at is the period from June 2007 through to the time of the discussions leading to the merger. They are saying that those actions brought about the SLC identified by the Competition Commission. We say that it is an error of principle to be looking at that issue rather than the issue identified by s.35(1)(b) and we have already looked at Appendices H and J and we say no conclusion was reached on the conclusion of the actual merger but that the conclusions in the decision, and I think we have looked at these but I will give the references again, paras. 5.81 to 5.82, 6.4, 6.13, 8.2 and 8.31(a) are all based on effects on competition of the period since 24th June 2007 not of the creation of the merger.

We say that leaving aside the pure legal question the Tribunal has no reason to grant a wide discretion to the CC to make a finding based on a manifest absurdity or simply the wrong question and, in any event, that this is not a question of policy but a question of fact and for that purpose I think it will be helpful to look briefly at the *IBA* case where the Court of Appeal gave definitive guidance which I think has been accepted in subsequent cases as definitive, and that is tab 1 of the authorities. Although there is a judgement of the Vice-Chancellor (as he then was) now the Chancellor, which comes first, and there is a

discussion of these issues from para. 43 onwards it is perhaps worth looking at para. 46. There is a reference to a judgment of the CAT and they express the view:

> "…that these words connoted more than a possibility and adopted what they described as a crude way of expressing the idea of an expectation as a more than 50% chance. No doubt this is right when applied to the single question which the Commission is required to answer under s.36(1)(b)."

But the matter was more fully discussed by Lord Justice Carnwath in his judgment and in particular from paras. 28 et seq, but I will just pick up paras. 81 and 82, and again there is reference in para. 81: "The Tribunal (without dissent) has interpreted 'may be expected' as implying a 'more than 50% chance'", but then he goes on to discuss the difference between the role of the OFT and the Commission in para. 82:

> "The difference between ss 33 and 36 lies in the nature of the conclusion to be arrived at. The question for the OFT is whether it "*believes* that (SLC) is or *may* be the case", the Commission is required to '*decide'* whether there will be SLC. Thus for the OFT, unlike the Commission, belief in the possibility of SLC is enough to trigger the next stage."

And so that picks up the point I was making to Professor Bain in relation to Appendix H. But then principles of judicial review at paras. 88 et seq, and this was a slight admonition to the Tribunal to go back to basics on the principles of judicial review, but the relevant part here I think is paras. 92 to 96 where they consider the intensity of review. Lord Justice Carnwath says:

> "A further fact relevant to the intensity of review is whether the issue before the Tribunal is one properly within the province of the court. As has often been said, judges are not 'equipped by training or experience or furnished with the requisite knowledge or advice' to decide issues depending on administrative or political judgment."

So there it is an issue of policy but then para. 93 says:

> "The present case, as the Tribunal observed, is not concerned with questions of policy or discretion, which are the normal subject-matter f the *Wednesbury* test, Under the present regime the issue for the OFT…"

and here for the CC – I add:

> "… is one of factual judgment. Although the question is expressed as depending on the subjective belief of the OFT, there is no doubt that the court is entitled to enquire whether there was adequate material to support that conclusion."

And then there is a reference to a well known case: *Edwards v Bairstow* and a dictum of Lord Radcliffe which is at para. 96, and in particular the italicised wording, the duty in this case of the reviewing court:

> "… is no more than to examine those facts with a decent respect for the Tribunal appealed from and if they think that the only reasonable conclusion on the facts found is inconsistent with the determination come to, to say so without more ado."

We would accept the gloss that has been put on this by the Tribunal in subsequent cases, but we do, with respect, say that it all depends what the precise issue is here and we would say that not only is this an issue of fact, but it is an issue where the Competition Commission has taken a particularly unorthodox approach of principle, and in those circumstances we say that the Tribunal is perfectly entitled, if it is so advised, to take a very different view to that of the Competition Commission and that the approach in *IBA* is entirely consistent with that submission.

If we then turn to, as it were, the way we put it as a matter of fact, where we say that it was perverse to find that the chain of events would have been different from what it was, or that Stagecoach would have exited the market, then first of all if we look at the findings, again, I think it is the same references, and we say that it is a complete *non sequitur* to say that if there had been no merger in 2009 then there would have been no market entry in 2007. It is irrelevant for these purposes whether Stagecoach foresaw or intended that PBL would be driven out of the market, or the effect might be to lead to a merger. For this purpose the simple question is: does it follow from the fact that a merger did not take place in 2009 that the events might have been different from what they in fact were or that Stagecoach would have left the market if that merger had not taken place, and we say it is a complete *non sequitur* and there is no evidence for either of those things. We say the first one is a bizarre finding and it would take particularly strong evidence to suggest that if the merger had not gone ahead in 2009 we might not have entered the market at all in 2007, and we say that there is nothing at all to support the finding that Stagecoach would have exited the market if the merger had not gone ahead.

THE CHAIRMAN: What do you mean by "exited the market"? Are you using that as a paraphrase of going back to the June 2007 situation?

MR. THOMPSON: Yes, gone back, as it were taken its tanks off PBL's lawn and gone back to where it was. There is no evidence for that, and in fact the paragraph I just showed you from appendix H suggests that the Competition Commission itself did not think that was likely and it was assessing the prospects for PBL on the basis that Stagecoach would have

remained on the market, so looking at it in terms of the convention of future looking test the finding at Appendix H12 was simply inconsistent with Stagecoach leaving the market.

THE CHAIRMAN: To put it a slightly different way, are you also saying then that if in June 2007 Stagecoach realised that there was no way that the regulatory authorities in any circumstances were going to allow them to take over PBL's business or assets. There is no evidence to say that, if they had known that in June 2007, they would not still have done exactly what they did do.

MR. THOMPSON: Yes, and I can put it slightly higher by reference to the manuscript note of the December 2007 meeting where I think both [former PBL Director] and [Stagecoach Director] recognised that there might be competition issues, at least at that time, but nobody said, "Are the facts logically inconsistent with your having entered the market, you would never have entered this market if you had realised that there might be competition objections to your merger". It was simply not an issue that anyone would ever have thought of – if that answers your question.

THE CHAIRMAN: Yes, I think it does, in that that is your case. It seems to me that the Competition Commission's case is that you can only see why Stagecoach acted as it did in that period after June 2007. You have to infer from that that what their intention was was to become sole supplier in Preston of bus services. If you had known that you were not going to be allowed to do that, you would never have started down that path. What you are saying is that there is nothing to suggest that that is the case – is that right?

MR. THOMPSON: That is certainly true. I am not sure it is even quite put like that. It is still opaque to us what the reasoning of the Competition Commission was that led them to take this counterfactual, but if that were hypothesised as a possible line of reasoning, that it is appropriate to go back in time because had they known what they now know, that there would be all this problem about the merger, they would never have entered the market. In a sense, that rather goes in my favour, I think, because there is no suggestion that Stagecoach is a particularly naïve operator that has no idea about the competition application to mergers. Indeed, there was another case in relation to Eastbourne that was going on in parallel to this, so Stagecoach is perfectly familiar with both the Competition Commission and the OFT, and so the suggestion that they would have gone into this in a naïve belief that all would be fine for them to take over a monopoly in Preston, that seems to me is not a finding that the Competition Commission makes and, in my submission, it would be another perverse finding if they sought to try and advance it now.

MR. BLAIR: Could I just ask you a small question about exiting the market. If you were to go back notionally to that date in 2007 what was – I think you may have told us this this morning – the state of play between the two companies at that time? It was not complete exit, was it?

MR. THOMPSON: At that time Stagecoach was running inter-city services to a variety of towns around Preston, some of which involved those services going through the centre of Preston, and to that extent they competed with PBL through the middle of Preston, rather as you can get on, I do not know, a coach to Oxford and it may take you some of the way and would compete with some local bus services, something of that kind, from London. There was also a small local service to a place called Penwortham, I think, where Stagecoach was already present, and I think PBL was not present on that. One of the implications of what happened was that PBL started up a service to Penwortham in competition with Stagecoach as, as it were, a retaliation to Stagecoach entering the market. The previous status quo had been a sort of uneasy truce with Stagecoach having presence in one or two parts of the inner city market, but by and large operating inter-city.

MR. BLAIR: So when you say go back, exit the market, do you mean go back to that temporary state of affairs?

MR. THOMPSON: Yes

MR. BLAIR: Thank you.

MR. THOMPSON: Although propositions four and five are important, I think they do overlap to a large extent with legal issues, so that was all I was proposing to say on them, and then to move on to the two, as it were, substantive findings of fact which was, first of all, in relation to the so-called period of abnormal competition, that Stagecoach did not act commercially rationally during the period from 24th June 2007 to 23rd January 2009. It may be that the words "commercially rationally" could be varied. There are obviously references to profitability, there is some reference to sustainability, as to whether or not this was a way that Stagecoach as it were for some reason could or should or might not have acted as it did. We say that there was really no evidence to suggest that Stagecoach was not acting commercially rationally. But there is a prior issue. It is not clear what the relevance of this issue was to the Competition Commission's analysis – for example, at paras.5.2 and 6.4 of the decision. One asks rhetorically, "How could the profitability or non-profitability of Stagecoach before the merger alter the realistic assessment of what would have happened in the absence of the merger?" We just think it is a non-sequitur.

For that purpose, we say, first of all, that it is not alleged that Stagecoach acted unlawfully, and we have referred to *Chester City*, and we have seen the exchanges in the pleadings. It is not alleged that we acted unlawfully. As I said, I think, in opening on the facts, there was here a clear commercial rationale to establish a firm foothold on the inner city market before PBL sold out to a more powerful competitor. That was accepted by the Competition Commission, and one finds that, for example – I gave one reference, but if we look in more detail at appendix J, tab 2 of the Notice of Application for Review bundle.

THE CHAIRMAN: I think the reason why it is considered to be relevant, as I understand it, is that in rejecting Stagecoach's evidence that all they intended to do was to take a 25 per cent share of the market and that they had no intention or wish to marginalise or drive out PBL completely, one of the reasons why they reject that as being what was likely to be behind what has happened between 2007 and 2007, is that they say that what you actually did went far beyond what was rational in order to achieve that goal, and therefore one infers from what you did that your goal was not simply to win that limited market share but rather to do what they find that you intended to do, which was to push PBL out completely. I think that is said to be the problem with it.

MR. THOMPSON: That may be what they think, but my point is how does that assist them in showing that this is something they should have borne in mind in making a realistic appraisal of the outcome of the market? Supposing the Competition Commission thinks we wanted a 50 per cent market share or a 100 per cent market share, what they found was that we would have gone back to June 2007 levels in the absence of a merger. In a sense, the more market share we wanted, just to take that example, how does it follow that we have therefore taken our bags and gone home if the merger had failed? It simply does not follow at all.

The point I was going to take you to is the positive rationale that I think it is common ground which is set out in appendix J, paras.19 to 21. It is the end of para.19 ----

THE CHAIRMAN: Is that p.J5?

MR. THOMPSON: Page J5, p.192 of the bundle. There is reference to [Stagecoach Director] but I think that is confidential, but I do not think it is confidential to [Stagecoach Director]:

> "[He] told us that Stagecoach expected PBL to sell its business to an operator other than Stagecoach and that selling to another, more efficient, better organised operator, would make it more difficult for Stagecoach to gain market share in Preston.

> If we accept this argument, Stagecoach had three options for eliminating this threat: (a) acquiring PBL, (b) competing PBL, away, or (c) acquiring a sufficient part of the Preston intra-urban market to make the market unattractive for a large competitor."

There is another reference at 21:

> "Stagecoach told us that the CC had ignored another option (d) whereby Stagecoach sought to acquire a sufficient part of the Preston intra-urban market to ensure that it had already consolidated such a position prior to (in Stagecoach's view) inevitable, eventual acquisition of PBL by a more efficient competitor from which it might have been more difficult to win a share of the Preston intra-urban market. According to Stagecoach, this is the option that is has pursued. Stagecoach further specified that it only sought a minority share, about 25 per cent of the Preston intra-urban market."

Then, at 22 they say that the Competition Commission rejected Option 4. Then they conclude,

> "Finally, as we conclude in para. 5.53 of the report, it was, in our view, 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".

THE CHAIRMAN: It is the sentence that you missed out which is the answer to the question that you posed rhetorically: What is the relevance of the losses that we are alleged to have made? The relevance is because they say that the scale and scope of your expansion and the fact that you were prepared to incur considerable losses indicate to them that you were not just going to look for the 25 percent; you were going all out to push PBL out of the market. That is why it is important to establish whether there was any evidence on which they could base a finding that the only proper inference to draw from the scale and scope of your expansion and the fact that you were going to incur losses -- The only inference to draw from that is that your ambitions were not limited to 25 percent of the market.

MR. THOMPSON: Yes. The point I am on here is that the Competition Commission itself appears to have accepted the rationale of obtaining a foothold on the intra-urban market.

THE CHAIRMAN: Where do you get that from?

MR. THOMPSON: Well, there are Options A, B, C, and D and the mere fact that they reject D does not suggest that they reject A, B, or C. So, the point here is that they accept that we were seeking to get a presence on the Preston market before a more prosperous competitor

bought PBL. In my submission that was the evidence of [Stagecoach Director], and it was a perfectly rational reason to try to come on to the market - whether it was as the Competition Commission said - with a view to effectively pushing out PBL or pre-empting PBL from selling out to a competitor - or whether it was, as we say, to get our foot firmly in the door before it was shut by an Arriva or a Go Ahead. I will come on to whether the Competition Commission had any basis to say that we wanted to kick the door down rather than put our foot in it, but for present purposes that was a rational, commercial reason to enter the market.

In relation to that objective and our conduct, there are a series of factors which we would rely on to show that our objectives were precisely as we said they were. First of all, the purchase of 25 relatively small buses which went up to the capacity of the Preston depot. I do not think that is disputed in itself. For example, it is stated at para. 5.5 of the Decision. [Stagecoach Director] gives evidence of it at paras. 19 and 27 of his witness statement. Secondly - and we have looked at this already - we say our approach, as we described it to the Competition Commission - was notably consistent with the discussions that were held with PBL. We have seen the original manuscript note of the December 2007 meeting. I will give the Tribunal the references. It is at Tabs 7. 9, and 10 where there is evidence in relation to those meetings. I do not think they are particularly disputed in the PBL evidence. Thirdly - and a specific example of what we say - the QPS proposals. Again, there is an original document which the Competition Commission seeks to play down, but which in my submission is notably consistent with our account of events, and notably inconsistent with the Competition Commission's. One finds that at Tab 8 of the bundle. In my submission this is a type of document which, again, is of particular evidential weight in that it is a contemporary internal document, an e-mail, between two employees of Stagecoach (a [Stagecoach employee] (and somebody will tell me who he was at some point) and [Stagecoach Director], who we have already come across, who was the managing director of Stagecoach North-West as one finds in the next tab, and in his statement). So, this is an internal contemporary document concerning the QPS. He was in fact a policy advisor. So, he has made comments on [Stagecoach Director]' e-mail. (Pause whilst read): The reason why this document is important, in my submission, is that it is an internal document, dated 20th August, 2008, which is clearly going into some detail about how a QPS would actually operate and unless the Competition Commission is alleging that this was some sort of elaborate fraud to deceive either the Competition Commission or the employees of Stagecoach themselves by wasting each other's time by asking fake questions and giving

insincere answers, this is clearly a document that is seriously envisaging the possibility of a QPS between PBL and Stagecoach and as the Competition Commission itself points out, QPSs did not come into force in this form until April 2009 and so it was clearly envisaging the possibility that both PBL and Stagecoach would survive on the market. So, it shows first of all that [Stagecoach Director], the managing director of Stagecoach North-West, had in his mind that he thought that PBL might still be on the market in April of the following year; and, secondly, that he was actively considering the possibility of a QPS. The Tribunal will recall that this is shortly after ended, and we say that the CC simply, I am afraid, was completely incompetent in the handling of evidence, that this is clear evidence that Stagecoach did envisage the possibility of PBL carrying on in business even after PBL was actually in negotiations with another company for its sale, and that it was in good faith open to the possibility of a QPS, there is just no other explanation for this document.

The further point is that contrary to the approach of the CC, Stagecoach repeatedly increased its prices after its initial entry and partially retrenched from that initial position, which is precisely what you would expect from somebody who wanted to put their foot in the door but in due course to make a commercial go of what it was doing, and you see that from the evidence of the CC itself, for example at appendix F, p.11, p.125 of the bundle. At table 4 you find Stagecoach's fares between January 2007 and February 2009, but most relevantly up to September 2008, that it was increasing its prices consistently, first of all in January, then March, then June, then September, then February 2008, 30th March 2008, 14th September 2008. So, for example the single fare went from 50p to 75p and return fares were abolished. In my submission that is perfectly consistent with a company entering a market in a tough way to get itself established and then raising its prices as and when it could to turn this into a commercial business and that again is inconsistent with the way the CC describes it.

THE CHAIRMAN: With the number of buses that you were introducing with the 25 new buses from the depot, did that give you capacity to go above 25 per cent as a sort of throwing down the gauntlet and then you would draw back to 20, 25 per cent ----

MR. THOMPSON: No.

THE CHAIRMAN: -- or it only enabled you to go to 25 per cent from that depot?

MR. THOMPSON: Yes, in fact the 25 per cent there is no magic about it, it is simply a rather rule of thumb response of [Stagecoach Director] when he was asked: "what percentage did you want?" He said: "I have 25 buses it is roughly a 100 bus market, so those buses would have given me 25 per cent." There is no more magic to that.

THE CHAIRMAN: No, I understand.

MR. THOMPSON: I think in reality he had never thought of the question until he was asked, but that was the answer he gave on the basis of how much percentage he would get with those buses.

MR. BLAIR: You do not have any other documents showing evidence of a target of a particular market share prior to [Stagecoach Director]'s evidence whereas you say he calculated if effectively off the cuff in response to the question?

MR. THOMPSON: No, I think the only documentary evidence, and I am not sure it is actually in the papers, but it is not controversial I think, is that there were internal papers of Stagecoach approving the purchase of 25 buses for this particular purpose.

MR. BLAIR: But it was always in terms of buses rather than market share?

MR. THOMPSON: Yes.

MR. BLAIR: Thank you.

MR. THOMPSON: If I may speak on behalf of [Stagecoach Director], I understand that all he was saying was that he looked at this market, he thought to get your foot into the door you needed 25 buses to run a series of services and that is what he did and when he was asked: "What will that get you?" he thought "Well roughly 25 per cent of the market". Obviously the CC thinks "Well, a big company like Stagecoach could have brought in 100 buses from London or built a new depot or done all sorts of things", and of course that is true, but our point is there is absolutely no suggestion that this was ever in Stagecoach's mind, and it is purely speculation on the CC's part that that was ever envisaged.

The other point is that there was a degree of retrenchment, I think you will have seen reference to one route being started and then withdrawn and that is at para. 36 on the facing page, p.124. Then at 38 and 39 there is reference to concerns, and some checking of the performance plus savings in the autumn and other options were to be considered. In my submission again that is not really consistent with the account of CC of Stagecoach being hell bent on kicking PBL out at all costs.

Finally, there is the passage that I have already referred to from [Stagecoach Director]'s witness statement, concerning the purchase of PBL, I do not think it is really in dispute that we did not pursue this in competition with Arriva, we allowed Arriva and Go Ahead bids to go ahead, in fact we do not seem to have known anything about them and it was only when KPMG approached Stagecoach that we considered the purchase of PBL on its merits, and again we would say that was strikingly inconsistent with the suggestion that we were hell bent on getting in there first and preventing anybody else from bidding. There does not

seem to have been any attempt by Stagecoach to purchase PBL after the discussions I think in 2006, although there may have been one or two informal discussions at the end of 2007, but it certainly was not any part of the CC's case that we repeatedly said that we would buy the company.

In summary, we would say that he CC's scepticism about our objectives is plainly unfounded. The minority share point, you will have seen how it came up, it was simply raised with us at the hearing by the CC, they complained that we did not raise it before, but we say the reason why was because we never thought of it as an issue, the CC has offered really no alternative evidence to suggest that we actually were seeking a larger share beyond the point, that the Chairman put to me, in their reasoning and we would say that the evidence on profit was itself a weak point, and one sees that for example from some of the material in Appendix G, p.137 of the bundle, There are actually three lines in this table but only two of them appear to be visible, it is figure 1 on p.138 of Appendix G.

THE CHAIRMAN: Yes, in my copy it is covered in yellow, which indicates it is confidential.

MR. THOMPSON: Yes.

THE CHAIRMAN: Do you have a redacted version in front of you?

MR. THOMPSON: I have two lines, I do not know whether it is confidential to remark on the angle of the lines, I was not making any greater point than that the red line is not a flat line.

THE CHAIRMAN: I see.

MR. THOMPSON: This is entirely consistent with [Stagecoach Director]'s evidence that although the business was tough it was moving in the right direction. So the red line is the contribution during this period and although there was a slight change in the direction at the end, we would say in commercial terms it was moving in the right direction, and that that is entirely consistent with our case that we were getting our foot in the door, and that it made commercial sense for us to persist.

PROFESSOR BAIN: Mr. Thompson, there are one or two questions I wanted to ask about profitability, and I would like to get your views on it. I also will possibly want to put them to the Competition Commission afterwards. It seems to me that what has been criticised here is an decision where you have to look at the losses you will incur in the short term against the revenue you expect to earn in the long term. On both sides there are expectations, what you expect to lose and what you expect to gain. What the Competition Commission seem to have done is to add up the actual incremental costs, and I think you have to include depreciation, you have to include costs of retaliation in this. They seem to have added all that up, but I have not seen any evidence of the Competition Commission

looking at the revenue that would come if the strategy was successful. There is some evidence of the revenue that would come if the strategy was successful from [Stagecoach Director] in his evidence of July 17th, where he said that he would expect each bus to earn about £[X] a year for ten years. So if you take it on a bus by bus basis, if you take the Competition Commission's figures of actual costs, which, given that it was all taking a bit longer than expected, was probably more than expected costs, that comes out to about £40,000 a bus. For that £40,000 a bus max you are getting £[X] a year minimum for ten years minimum as revenue. On that sort of calculation it seems to me clear that this would be expected to be a profitable enterprise. If you are only paying £40,000 for £[X] of revenue over the ten years per bus, on any sensible rate of discount that is profitable.

I know that [Stagecoach Director] said he did not do the calculations. He says quite clearly that he did not need to do the calculations. If these figures are about right, is there actually any need to do detailed calculations to see that this is a sensible proposal?

MR. THOMPSON: My broad submission is that this was a perfectly sensible and rational proposal, and I had not done those calculations. [Stagecoach Director] is a very experienced businessman, but he, I think, has been criticised, he is not the most bureaucratic businessman and he does more things on instinct and experience than on maybe that type of calculation. So I do not know whether any such calculation would have been conducted. I certainly have not seen it.

PROFESSOR BAIN: I was not suggesting it would have been conducted, but I am suggesting that if you have these sort of broad magnitudes in mind you do not actually have to do any calculations in any detail, because the answer is obvious.

MR. THOMPSON: Broadly speaking, it is a long term business and if you do have a profitable projection over the time of the business then it is going to make sense.

PROFESSOR BAIN: Thank you.

MR. THOMPSON: There is actually one finding in the Competition Commission Appendix G which might be said to bear on this. It is para.60 of Appendix G, p.148. This obviously is on the assumption that a monopoly is achieved, and on that basis for the purposes of a recoupment analysis which is somewhat redolent of the predatory pricing analysis the Competition Commission has done its own calculation and suggested that this would make sense on that basis. I do not think that is the basis on which you are putting it to me, but it may be that that is relevant to the type of reasoning that you are putting to me.

What I was going to say, and perhaps more naively and legally, was simply to look at the conclusion of the Competition Commission at para.5.53 of the decision. I think it is a point

I may have made in opening. It is p.29 of the decision., which is simply the point that the finding of the Commission there:

> "The scale and nature of Stagecoach's expansion described in paragraphs 5.45 to 5.51 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."

That point, again there is no real inconsistency between seeking a minority share and causing damage to the viability of PBL, so if that was the reasoning then, in my submission, it is another non-sequitur by the Competition Commission. I think [former PBL Director] suggested that ten buses would have been enough to knock PBL's profitability, and you can see why, given how marginal its profits were. So the mere fact that it might have been foreseeable that entry would cause considerable damage simply does not show that [Stagecoach Director]'s ambitions were not precisely as he said they were, which was to get a 25 per cent, and tough on anyone who wished to compete with him, but not that he was seeking anything more.

THE CHAIRMAN: Is there any evidence that you knew, or Stagecoach knew, of the rather precarious profitability of PBL at this time?

MR. THOMPSON: I think we would accept that we had access to PBL's accounts. I think it had published accounts, but beyond that, as I understand it, all there was was a general sense that this is an employee owned company, was being managed rather for the benefit of the employees and, quite laudably, for the benefit of the people of Preston, but it was not pursuing a particularly commercially minded approach.

PROFESSOR BAIN: I was going to say, is there not something in the papers saying that Stagecoach had had its people run over the figures for PBL in the late spring of 2007, would it be, prior to the discussion where they were going to ask [former PBL Director] again whether he was prepared to sell, expecting to get the answer "No", but at that time presumably if they were going to approach somebody about the possibility of buying you would have had to have done your homework so that you would have some idea of what you might offer for it?

MR. THOMPSON: Yes, that would suggest the first half of 2006. I do not have the reference under my fingertips, but that does sound right.

PROFESSOR BAIN: Early in this stage they did look at PBL and they looked at all their figures, but that, as I understood it, would be in the context of them raising the issue again of the possibility of buying.

MR. THOMPSON: Yes, I think that is right, so they would have had that degree of knowledge, but I do not think they had, as it were, detailed chapter and verse about how parlous PBL's position was in late 2007/early 2008. That probably would not have been shown by the accounts anyway.

THE CHAIRMAN: Yes, but that then really brings you on to the point about what you would have foreseen about how PBL would react to your market entry. Yes, it might push them into loss-making, and there are a number of ways they can react to that, not all of which result in them going to the wall.

MR. THOMPSON: No, exactly, and our evidence, and we say perfectly rational evidence that the Competition Commission has no real basis to object, is that we would have expected someone in the position of PBL, faced with someone like us, to pull in their horns rather than to say, "We will take on Stagecoach", because they just were not going to be able to knock us out in that way, and so it proved.

I have mentioned the QPS point and said that I submit that that is an important piece of evidence, so I will not repeat that.

I think that then takes us to the third party evidence and whether or not what we did, coming into the market as we did, was consistent with the views of [X] and [X]. I do not know whether we just pass over that. I think the note is pretty much self-explanatory.

THE CHAIRMAN: I think we do want to hear what your submissions are, both in relation to Ground 2 and Ground 3. If we have to go into Camera now, it might be useful to do all the submissions that you want to make on any relevant ground in relation to that note then, even if it means taking things a little bit out of your turn.

MR. THOMPSON: That is fine. I suspect you will have anticipated, both from the pleadings and from our original grounds that Ground 3, to some extent, is a bit of a mirror image of Ground 2. So, I would not expect to take a long time. I am happy to take that aspect of it now as part of the note.

THE CHAIRMAN: In relation to that note then, that was limited to a confidentiality ring -- or, the disclosure of that material on which that note was based is limited to a confidentiality ring.

MR. THOMPSON: Yes. On our side it is simply [Stagecoach Director] and myself and three of my instructing solicitors.

THE CHAIRMAN: I think what we want now is that everyone who is not within that confidentiality ring should leave the room. Could you please make sure that only people in the confidentiality ring, which does not include members of the public, are in the room. I think you are only entitled to be in the room if you have signed a declaration to the Tribunal either saying that you are bound by the confidentiality undertaking or you are a member of the staff of the Competition Commission. If you do not fall into either of those categories, then you should leave at this stage, please.

(For proceedings In Camera see separate transcript)

THE CHAIRMAN: Yes, thank you.

MR. THOMPSON: What I was proposing now was to deal quite shortly with some of the specific facts, which, as I understand it, are relied upon by the Competition Commission to show that market entry by Stagecoach was not driven by normal commercial considerations. The first one, which we deal with at para.90 of our skeleton argument, concerns the possibility that instead of coming on to the market Stagecoach could have made further savings in the operation of its own depot, which they hang on a particular piece of evidence given by [Stagecoach employee], and as we say, it was pure speculation that a commercial benefit or increase in profitability could have been achieved by this means, and we say that Stagecoach was a profitable company and an efficient company and that it was entitled to take the view that it was a better bet to enter a new market than to try and keep paring away costs at its depot.

The second point. The possibility that Stagecoach itself might have been sold to a third party rather than engaging in this enterprise of entering this market. Again, we would say that was pure speculation. We deal with that at paras. 91 to 93 of the skeleton argument. Thirdly, the Commission's scepticism as to our market share aspiration. I have mislaid the reference to that -- Paragraph 94 through to para. 97. We have already discussed that. We say there is no basis to doubt Stagecoach's evidence on this. In any event, it accepts the rationale of Stagecoach's desire to pre-empt purchase of PBL by a third party by establishing a presence in advance of that happening. So, we say it is not relevant. Fourthly, the question of whether PBL, had we operated in a more commercially minded manner, would, as it were, have frightened us off because of their monopoly position and their cash reserves. We deal with that at paras. 98 and 99 of the skeleton. We say that is quite unrealistic. There is absolutely no basis to think that Stagecoach should have been deterred by PBL. We were a larger efficient operator. We had an adjacent depot with spare capacity. Indeed, the Competition Commission itself found that we were a potential

competitor and strong potential constraint. So, it is hardly consistent to say it was not realistic for us to enter.

However, our main point is that the entry to pre-empt third party entry was a clear and consistent rationale for entry which was accepted by the Competition Commission itself. The reasons why the Competition Commission was sceptical as to our rationality simply do not stack up. The other three points they rely on are the lack of business records. That we deal with at paras. 111 to 117 of our skeleton. We say that is irrelevant. We say it is not actually true in that there was evidence of the 25 buses being ordered albeit not in any very detailed strategic documents. We say that simply reflects the character of the company.

The Competition Commission objects to our targeting profitable routes, which we deal with at paras. 118 to 121. Frankly, I do not really understand that point. In my submission it was a perfectly rational thing for a large company wishing to break into a market to target the profitable rather than the unprofitable or marginal routes - just as if DHL wanted to get into postal services in London they might very well go for the core business services rather than seeking to deliver expensive mail to remote corners of the country. So, in my submission there is nothing surprising about us targeting the core routes in a way to establish ourselves.

Finally, the issue on period of losses which we deal with at paras. 122 and 127. We say that our position was perfectly normal - that [Stagecoach Director] was obviously the best person to judge that issue. We have obviously been looking at that issue to some extent by reference to the confidential materials.

THE CHAIRMAN: Just as to how it works as a matter of fact -- There is a route which goes along a certain number of roads in a pattern through Preston that PBL is running. That it calls, say, Route 40. You then decide to compete on that route. PBL are currently running, say, buses along that Route 40 once every quarter of an hour or once every ten minutes (I do not know how many buses you need in order to do that - they presumably circle round). You enter that route. You go along the same road and stop at the same bus stops, but you do not call your bus route 40 - you call it Route Whatever-It-Is. Or is your bus also the No. 40?

MR. THOMPSON: It has the same number. Where it is exactly the same route it will have the same number.

THE CHAIRMAN: Right. So, you would then just choose a time which is -- Stop me guessing. Do you know roughly how it works? How do you enter a route? You then decide whether you are going to add one additional bus per hour or two additional buses per hour in addition to what PBL run? Then they have to decide whether they are going to cut back

their frequency? I am just thinking more of how it actually works -- the logistics of how you enter a bus route.

MR. THOMPSON: I can clearly take instructions on the minutiae, but as I understand it - and as a bus user, for example - most buses seem to come along perhaps every ten minutes whereas on a concentrated route you might come a little more frequently. But, I think the issue that arose here was that more buses were coming than was normal for the volume of passengers. Therefore, at least initially, there was a certain amount of jockeying for position at the relevant bus stops and in terms of the relevant routes. But, the point I am making its that it is not surprising that it was on such targeted routes where there were passengers rather than routes where there were no passengers.

THE CHAIRMAN: Yes, because when you enter the number of passengers - assuming they remain relatively constant, and of course you would hope that it would grow if there were more frequent or better buses in some way -- but, the same number of passengers is then going to be spread over a larger number of buses.

MR. THOMPSON: Yes.

THE CHAIRMAN: So, all of the buses are going to run at a lower percentage capacity.

MR. THOMPSON: Yes. The figure that has been good for me - and it would be broadly what I would have expected - is ten minutes. But, say it was fifteen minutes -- Say PBL was running buses very fifteen minutes down a particular route, then the obvious think for Stagecoach to do was to come in the middle. So, there would have been buses then coming every seven and a half minutes. Good for the passengers in a sense, but it obviously cuts into the profitability of the service for both in that both will get pure passengers. The evidence that we have from [former PBL Director], for example, is that where that happened, broadly speaking, Stagecoach picked up 25 to 30 percent of the traffic. So, PBL's traffic was cut to 70 percent broadly speaking.

PROFESSOR BAIN: There was some evidence in the papers to suggest that the Stagecoach buses left, say, a minute before the other ones in order to cream off more than that.

MR. THOMPSON: I agree. There were some allegations, certainly by PBL as to how it was conducted.

THE CHAIRMAN: That was QPS as opposed t o ----

MR. THOMPSON: I think the QPS goes a bit beyond that in that it sets out a number of the quality standards beyond simply timing. I suspect part of what the Traffic Commissioner was doing was trying to avoid that type of aggressive competition getting out of hand.

THE CHAIRMAN: Let us leave it there. There is furious note-writing going on on your side, but it may be that in due course if someone could produce just a couple of paragraphs to summarise ----

MR. THOMPSON: Yes. It is not a point I have been particularly thinking about, but it may well be that there is a material in the Decision about exactly how it works, some of which will be accepted; some of which will not. I think from our perspective the political wind was very much against us because PBL was the good old incumbent and we were the nasty entrant. So, we feel that the presentation was somewhat skewed against Stagecoach.

THE CHAIRMAN: Whilst I am on this, the other point that we were thinking about was this registering and de-registering of routes - some indication as to how that works.

MR. THOMPSON: Yes.

THE CHAIRMAN: But, I do not want to take up time now. It might be useful to have that bit of factual background.

MR. THOMPSON: I am sure we could produce something overnight if it is not in the materials already.

THE CHAIRMAN: Thank you.

MR. THOMPSON: I think that is all I wanted to say about my sixth proposition ----

THE CHAIRMAN: Just to go back. You talk about pre-empting third party entry. Do you accept that when you say 'third party entry' you mean by somebody else buying PBL?

MR. THOMPSON: Yes.

THE CHAIRMAN: You do not think there was room for a third entrant?

MR. THOMPSON: No, I do not think it has been suggested that three would have been a happy situation in this market.

THE CHAIRMAN: No, I just wanted to clarify that.

MR. THOMPSON: I think it is more a question of whether the two would have been sustainable, and there is at least some evidence from PBL that they thought it would have been but it was not really a world they wanted to live in, they wanted to drive Stagecoach out.

We then go on to the other key point that the CC identifies, which was their finding that Stagecoach must have foreseen that its conduct from 24th June 2007 onwards would have the effect of driving PBL out of the market or marginalising it as a competitor, and one finds that – I think we have looked at it already, it is at 6.4, these are the two factors that the CC relied on.

Again, we make the preliminary point that it is not clear what relevance this issue has, it is not alleged that Stagecoach acted either unlawfully, or that it acted intentionally. In the

absence of any such allegation it is difficult to see how Stagecoach's state of mind between June 2007 and December 2008 could affect the likely outcome in the absence of the merger, so we find it difficult to see quite how this issue is relevant. But in any event we say that there is clear and consistent evidence that this was not the case and the material we have looked at already, first of all the 1st December discussions, the contemporaneous note, that is the notice of appeal bundle, tab 7, there is evidence the two companies could have survived – that is at tab 12 of the same bundle, paras. 16 to17, there is the QPS discussions which we have already looked at, tab 8 of the bundle, there is the settlement with the Traffic Commissioner, which is at tab 12, para. 20 for example. There is the limited scale of the entry, the price increases and the partial retrenchment, and there is the fact that Stagecoach made no attempt to purchase PBL until it was approached by PBL in September 2008. Finally, there is the point we develop as our fourth key point which was that the PBL reaction was not either rational or foreseeable, and one finds that again at paras. 16 and 17 of tab 12. It appears to have been a dogged view of [former PBL Director] that he was going to drive Stagecoach out of the market even though it was pointed out to him that PBL was not realistically going to be able to do that, it was making losses in the attempt, even increasing its losses.

We would say that there was no evidence at all to support the Competition Commission hypothesis, there is no documentary or witness evidence to support its analysis and the contemporary documents and, in particular, the minute of the December meeting and the QPS, the internal email, are both entirely inconsistent with the CC's case.

If we then look at the specific facts relied on by the CC to show that Stagecoach must have expected PBL to be driven out, we have looked at a number of them already but if one then looks at the specific issues, there is the issue of capacity, which we deal with at paras. 131 to 136 of the Skeleton Argument, where the CC finds that we had additional capacity, we have looked at this already. The evidence is that we ordered 25 buses, that that was indeed the spare capacity of the depot and it was those buses, give or take three or four buses with variations over time, that were actually operated. There is no evidence at all that the CC has adduced that Stagecoach had any plans to divert resources to Preston and no evidence to support the CC finding that Stagecoach would not have been satisfied with a 25 per cent market share, indeed, all the evidence is to the contrary in that they purchased 25 buses and it was those 25 buses that filled up Preston's depot, so we say there was no basis for that finding.

There was no basis for the CC to reject the initiatives to end the bus wars as genuine. Again we have looked at the contemporary documents, and there is no evidence that those documents are either inaccurate or that the statements made in them were not sincerely made.

The possibility of a third party acquisition as a way of keeping PBL on the market, that is dealt with at paras. 146 to 147 of the skeleton. The CC gives no convincing reason why it rejected that as a possibility. There were in fact two other major companies, even in the second half of 2008, Arriva and Go Ahead, that sought to purchase PBL and they did not rule it out as totally out of the question. Indeed, the contemporary evidence of [former PBL Director] in his March 2008 note which we have looked at, is that he, as the operations manager of PBL, regarded it as a realistic possibility at the end of 2007, and he was pressing for costs savings to facilitate that. We say that there is no evidence that could not have succeeded, or that Stagecoach could have anticipated in June 2007 that it could not have succeeded.

Finally, in relation to the PBL reaction, paras. 149 to 169 we say that there is absolutely no evidence that PBL was expected by Stagecoach to take such an aggressive approach. The CC refers to one note where there is some reference to the possibility of retaliation. That falls far short of what actually happened, and the evidence of [former PBL Director] is that he regarded this as a policy that was misguided and that it would have been much better for PBL to seek to make itself more efficient rather than incurring additional costs which put it into increasing lack of profit. We say there is no evidence that Stagecoach could have anticipated that this is how PBL were going to react. So overall we say that quite apart from the relevance of propositions 6 and 7, all those findings, there was no proper basis for the Competition Commission to make such findings.

PROFESSOR BAIN: Mr. Thompson, the Competition Commission do rely on having looked at the bus industry over a very long period, is there no evidence from the bus industry generally of people retaliating when they are attacked?

PROFESSOR BAIN I am sure bus wars have occurred.

MR. BLAIR: It seems to me it might have been unreasonable to expect that there would be no response.

MR. THOMPSON: I do not want to put my case too high.

PROFESSOR BAIN: I think you are.

MR. THOMPSON: Well I am sorry, but this particular response by this particular company against this particular entrant, I do not think it was necessarily foreseeable that an employee

owned company would deliberately set out to incur additional costs by expanding its services when faced with a strong market entrant such as Stagecoach.

PROFESSOR BAIN: But equally would you agree that it was not inconceivable? You would not predict that they would do it but it was the kind of event that was not terribly unlikely.

MR. THOMPSON: That may be fair, but I think that the CC need something stronger than that because they say it must have been foreseen that this would happen, but I think this is probably at the margins in one sense; no, I would not dissent from that.

THE CHAIRMAN: I think you would probably say in order to justify rejecting the consistent testimony given by people from Stagecoach they would need fairly strong grounds.

MR. THOMPSON: Yes, indeed, but it must have been self-evident that a body such as PBL would go further into the red rather than pulling back, and the evidence of [Stagecoach Director] both before the CC and in his witness statement is that is not what he was expecting. He was expecting them to pull back a bit, and that is consistent with the contemporary note saying "We have to find a way through this, we are not intending to pull out, so rather than a merger which might be difficult, let us try and see if there is some alternative. We say that is entirely consistent with the documents and with commercial realities.

I think I have indicated that grounds 3 and 4 I was proposing to take fairly shortly because I think they do go over some of the same ground. In relation to third party evidence effectively I have already dealt with that. The point that I would take is that the Tribunal will recall that there were two key PBL witnesses, [former PBL Director] and [former PBL Director]. I do not think it is confidential for me to refer to them by name, I have done it a number of times. The approach of [former PBL Director] was supported by the contemporary documents. He has taken a consistent approach throughout, and we consider that it was unfair for the Competition Commission systematically to favour the particular position of [former PBL Director] as against the position of [former PBL Director], and to make findings on that basis. So that is a further point.

THE CHAIRMAN: What was [former PBL Director]'s position within the merged business at the time?

MR. THOMPSON: I think he was the operations manager throughout. He was a director of the company, but he was also the operations director apparently.

THE CHAIRMAN: So he became a director after the merger.

MR. THOMPSON: I think he still is.

THE CHAIRMAN: Of what? Of Stagecoach North-West?

MR. THOMPSON: I will look at his witness statement. In his witness statement, para.1, he is the operations manager of Preston Bus PBL and he has held the position since February 2000. That is what he says in his statement.

THE CHAIRMAN: What does that mean post-merger?

MR. THOMPSON: He is not a director of Stagecoach, he is now a manager of the Preston business, which is currently being held separate under the undertakings.

THE CHAIRMAN: Yes, thank you.

MR. THOMPSON: The third point which I think we have already dealt with is the minority share issue. There is obviously a substantive issue about whether or not they had a reason to object to it, but there is also a procedural aspect to it, that they claim that we raised the matter too late. We say that that is singularly unfair. First of all, we raised it in substance in our correspondence with the OFT in March, but as the Tribunal will have seen it was only a matter that was raised against us by the Competition Commission in its issues paper and then at the oral hearing. We then gave an answer and we have given a consistent answer ever since. That answer is a rule of thumb answer, 25 buses, 25 per cent of the market, roughly speaking. So there is nothing mysterious about it and we feel that it is inappropriate the way that that is being dealt with by the Competition Commission.

Finally, and I do not think I am proposing to go into any more detail than this unless there are specific procedural issues that are of interest to the Tribunal, we say that systematically the Commission rejected the factual evidence of Stagecoach, including evidence given in formal statements which it would have been a criminal offence, I believe, to have falsified – it systematically rejected or cast doubt on in a way that is really quite inappropriate for an objective investigation of a matter by a public body, except on the basis of clear documentary or conflicting witness evidence which casts doubt on that. We would say a fair reading of the evidence, including the evidence from PBL, was almost invariably entirely inconsistent with the approach of Stagecoach and there was no proper basis to reject it.

We have dealt with the confidentiality issue already.

I now turn finally to the issue of remedy, and in a way that is a sort of microcosm of the bigger case, in that there is a legal issue about how s.35 works, and then there is the factual question of how the Competition Commission exercised its discretion, if it has it, in this particular case. If one goes back to s.35, tab 16 of the authorities ----

THE CHAIRMAN: Is it your case that even if we reject all the other grounds of appeal the remedy is still disproportionate?

MR. THOMPSON: I think it is pretty narrow if everything else fails. Are you inviting me to hold fire on any submissions on the remedy, or was that just ----

THE CHAIRMAN: I just also have in mind the other note that you handed up. Go ahead with what you were going to say.

MR. THOMPSON: It is a fairly short point. I am nearly at the end really because the first point, and I think it probably is useful to have it in mind for the overall case, is tab 16 of the authorities, which was p.23, s.35. I am sure the Parliamentary draftsman had a good reason for this. It is a slightly tortuous approach. The jurisdiction for a remedy is in 35(3). It says:

> "The Commission shall, if it has decided on a reference under section 22 that there is an anti-competitive outcome (within the meaning given by subsection (2)(a)), decide the following additional questions ..."

Then it sets out how the Commission is to exercise it. So the initial point is, is there an anti-competitive outcome, and that is defined in 35(2) by, for example, (a), which is relevant here:

> "... 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 ..."

I am not quite sure why it was done like that. It effectively repeats s.35(1), but rolls them up together:

> "... 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 ..."

So it is effectively the two together. That is the relevant one here, but I think it is worth looking at 35(2)(b), which is relevant anticipated mergers, and it says:

> "... arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation and the creation of that situation may be expected to result in a substantial lessening of competition ..."

So at least in that case the concept of an anti-competitive outcome is quite narrow and is focused on the situation that would happen in the future, and there is obviously no element of past there. We would say, by the same reasoning, the scope of the power under 35(2)(a) must be narrowly focused on the impact of the relevant merger situation. So it is, as it were, another plank of the ground one argument about the scope of the power.

We say that 35(3) needs to be read by reference to that fairly tight definition, but requires the Commission to decide the following additional questions:

"... whether action should be taken by it under section 41(2) for the purpose of remedying, mitigating or prevent the substantial lessening of competition concerned ..."

We would say that arising from the creation of the merger –

"... or any adverse effect which has resulted from, or may be expected to result from, the substantial lessening of competition;"

Then there is reference to recommending the taking of action by others; and then (c):

"... in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented."

So we would say that the scope of the power on remedies is narrow and is focused on the adverse effects on competition arising from the creation of the merger here for the purchase on 23rd January, 2009. I think the Tribunal will anticipate that my criticism is that here the remedy, as well as the substantive analysis, focuses on restoring the position independently of the period of abnormal competition rather than remedying the impact of the merger and that the provisional findings of Appendix H, like the findings of the OFT showed that the impact of the merger was much more, as it were, localised and was a question of whether or not PBL could have been sold off either as a going concern or its assets sold off, and whether or not that would have been a less anti-competitive outcome than what actually happened. We say that the remedy, like the substantive analysis should have been focused on that narrow question and that that in one sense is independent of the overall analysis that it is quite clear on the statute that the Competition Commission is not given any general power to remedy issues in the market that it considers to be unsatisfactory. Its power is limited to remedying the impact of mergers and, here, the impact of the purchase in January 2009.

If you look at it as a matter of substance - our Proposition 10 - we have two objections: one which effectively simply flows from the statutory point, which is that this remedy of reconstituting PBL, including its assets and routes as they stood prior to 24th June, 2007 goes beyond what was required to remedy the effect of the merger as a matter of substance. There was no need for PBL to reconstituted in all its glory for that purpose. Then we have two specific complaints - the issue about a possible restrictive covenant ----

THE CHAIRMAN: Yes. From what they say in Section 10, particularly 10.43 onwards, they did not try and re-create the pre-June 2007 situation. What they tried to really do was reverse the changes that had been made post-merger in March 2009. At 10.48 they say,

"We did not consider it was necessary to restore precisely the same conditions of competition that prevailed. The aim of this remedy is to reinstate rivalry between two operators, each with extensive coherent neighbouring networks ... Provided this could be achieved we would not necessarily be concerned about an outcome that resulted in Stagecoach having a stronger presence in Preston than in 2007".

It is not quite right to say that they were trying to turn the clock back - unless you say that that was not actually reflected in the content of the ----

MR. THOMPSON: I think it was really 10.8 that I had in mind.

"In accordance with our guidelines, 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 [that is okay] 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".

So, they seem to be thinking that that is what they are trying to do. Rather than restore the position that existed in December 2008 they seem to be seeking to restore the position in the summer of 2007. Likewise, in paras. 10.44 and 10.45, when they are considering whether this would be a good remedy, they say it would be on a similar scale to that which existed between Stagecoach Preston and PBL in May 2007. Likewise, at 10.45 - in May 2007. Certainly my impression is that that was what they were aiming to do - to avoid the consequences of the period of competition since Stagecoach's market entry rather than to deal with the consequences of the merger. They use the words 'resulting from the merger', but it is clear from the Decision itself that what they actually look at is the effect of the period of competition.

THE CHAIRMAN: Perhaps we should wait to hear what they say they did, and then maybe you can respond to that.

MR. THOMPSON: There is just one narrow point that [Stagecoach Director] feels strongly about, and which I therefore will make. That is that at para. 5.6 there is reference to the launching of the services by Stagecoach - Service 11 to Gammell Lane; Service 9 to Moor Nook; Circular Services 19 and 22 to the Royal Preston Hospital; Service 33 to Tanterton. I think the bulk of those services broadly corresponded to the services that were already being offered by PBL. But, Services 19 and 22 were significantly different - I think it is common ground, but Mr. Unterhalter will say if not - and, as it were, a superior service to the service being offered by PBL. It is a particular grievance of Stagecoach that at 10.62 of Appendix

D certain commercial services, including Routes 19 and 22 is going to be restored to PBL. That, in fact, in our submission, is disproportionate in quite a narrow sense in that that is in fact one of Stagecoach's own new services, and it is particularly aggrieved that it should have to not only reconstitute PBL at a pre-June 2000 level, but they should, as it were, give it a new, improved service for nothing, for the pains for having taken it over in January 2009. The other specific point is the one we have raised about the restrictive covenant. Mr. Unterhalter quite correctly points out that the Competition Commission does not require there to be any restrictive covenant. But, they leave it open that they will allow a restriction on Stagecoach for a period of up to twelve months. Again, Stagecoach is somewhat aggrieved that for having taken over a company with the purpose being to restore conditions as they were in 2007, the Competition Commission not only finds what we would not have entered in June 2007, but that we should be somehow precluded from entering. But, that is a very narrow point. I would accept that in the context of a sale, a restricted covenant might be needed as a matter of commercial necessity. I simply make that narrow point.

THE CHAIRMAN: There was a point you made either in your skeleton or in the Notice of Appeal about the depot - that you objected to the inclusion of the depot and said that just a package of routes and may be lending them space in the depot would have been all right. Are you pursuing that?

MR. THOMPSON: I think that the point we essentially take is that the Competition Commission reached two decisions in very short order, one in relation to Eastbourne, and one in relation to Preston. In relation to Eastbourne they specifically found that a depot was not required because you could perfectly well launch the routes from outside or by getting access to somebody else's depot. Assuming PBL is off the scene but the depot is still there, there would still be two depots in Preston with significant capacity for the provision of services to Preston, and so on the face of it there is no reason why a divestment of routes would not be a sufficient remedy, that is the point. But obviously we recognise that this is an area where the CC will enjoy some discretion so I do not think I put it at the forefront of my case, because essentially that was an issue of judgment. We say that in Eastbourne they reached a different judgment and there is no real reason why this would not have been a perfectly good situation and solution here. Can I just ask if anybody else wishes me to say anything else?

THE CHAIRMAN: Of course.

MR. THOMPSON: (After a pause) There is just one other procedural point that I failed to make which is just as there were issues about third party views in relation to the duration of losses

we say that before making a finding against us in relation to capacity, so saying that we could have expanded our services, they should have made inquiries of other third parties, and in fact the same goes in relation to the reasonableness of PBL's response. The CC said that nobody said that PBL acted unreasonably, and made something of that in the decision. In fact, they were never asked, and we say it is procedurally very questionable to make an assumption as to the views of third parties who have never been asked, and have been asked about other things, so they are both points really about the treatment of third parties, but otherwise I think those are our submissions.

THE CHAIRMAN: Thank you very much, Mr. Thompson. Mr. Unterhalter, we would like to make a start on your submissions. I do not think we can sit much beyond half past four, but let us make a start on ground 1 at least.

MR. UNTERHALTER: Thank you. In the course of our learned friend's address, I think the issues have been quite substantially crystallised as to the differences that lie between the parties.

Fundamentally, it is Stagecoach's submission that the analysis that was done in the decision simply sought to attribute the significant lessening of competition to the conduct that had occurred and so the causal analysis was actually rawly done simply because it was looking at the wrong thing, not the merger but the conduct that preceded the merger, and so it is contended that that was an error of law because it simply fails with fidelity to follow the requirements of s.35(1).

We submit that one has to begin the analysis by examining the reasoning that was actually used and not the summary that is offered by way of criticism on the part of Stagecoach and to that end if I could ask the Tribunal to have regard once more to the decision and the relevant provisions that really deal with the counterfactual.

In the first place, if I could ask you to turn to para. 5.82, which is on p.34 of the decision because this is a conclusory paragraph that introduces the counterfactual and the basis upon which it must be considered.

What is said here is that:

> "Hence 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, i.e. 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."

Therefore in setting up the problem, and in the reasoning that is offered, there is no effort to seek to determine whether there was a significant lessening of competition attributable to the period of abnormal competition, the issue that is posed in para. 5.82 is to say: "What should we use as the counterfactual?" In other words, what would have happened as the words are used: "had the merger not occurred?" which is precisely what is required under the guidance and is precisely the causal analysis that is ordinarily followed in determining questions as to result.

There then follows a consideration of two possibilities, the one is the proposal that was made by Stagecoach and that is captured in para. 6.1.

> "In a submission to us, Stagecoach made the following arguments:
>
> > (a) PBL was a failing firm. Absent the merger, it would have been unable to meet its financial obligations in the near future and would have been unable to restructure itself successfully.
> >
> > (b) A third party would not have been able to restructure PBL …
> >
> > (c) The most likely outcome for PBL under the counterfactual was that it would have entered administration and would have been liquidated. Its assets would have been unlikely, in those circumstances to have been acquired to provide local bus services in Preston."

In other words, the submission that Stagecoach made was that it was inevitable, even absent the merger that the assets of PBL would exit the market and consequently under that counterfactual there would be unproblematic consequences for the merger, which was no worse than the counterfactual posited by Stagecoach.

It is in considering that proposition that the Commission then determines what it thinks is the correct counterfactual, and it rejects the failing firm, and I shall come in due course to the reasoning that is adopted for the purposes of considering the failing firm, but the analysis is simply not to suggest that the failing firm can be allowed as a relevant counterfactual for the purposes of deciding what would have happened absent the merger. The analysis then proceeds to consider how that counterfactual should be constituted, and then there is the critical reasoning that one finds after the guidance is referred to in 6.3, which one finds in para. 6.4 of the decision.

"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 …"

and it recites various portions 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."

- the very factual matters that our learned friends have been treating of in some detail.

"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 marginalising it as a competitive threat to Stagecoach."

I pause to interrupt for a moment, which is to say putting aside for a moment whether there is a factual basis for the attribution of abnormal or unsustainable. This is then how the counterfactual is posited. 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 the period reflects the rivalry that could be expected to occur in the absence of the merger. In other words, the Commission is posing the right question under any conception of a counterfactual which is, absent the merger, what do we think would be likely to occur? They consider that the 18 month period before the merger, and leading up to the merger, is wholly atypical of normal rivalry in this particular market. It says that for a number of reasons. It says so because the reasons that motivated Stagecoach to enter were not the ones that it claimed – i.e. the 25 per cent market share postulate which it rejected, and again we can come to why that was so. It did, as a matter of fact, reject that postulate.

It also then said that the kind of rivalry that was engaged between these two companies was unsustainable and consequently does not reflect any kind of market norm of normal rivalry. Again, one can debate the factual premises of that, but the point of the endeavour in para.6.4 is to construct a counterfactual which, in the judgment of the Commission, gives a better sense of what will happen absent the merger, because it considers that the benchmark or the reference point of the last 18 months is not a reliable guide to the future.

Our learned friend interestingly said at a certain point in his address to the Tribunal that he would not object to a consideration of the past for the purposes of determining what would plausibly happen in the future absent the merger. We think that a significant and correct proposition to advance to the Tribunal because that is precisely what the Commission did in

6.4. It said, "When we observe the conduct of the last 18 months we find that it is characterised by features that simply do not give us a reliable guide to the future".

One can perfectly understand, for reasons that we will develop in some greater detail, why that would be said, because even the portions of evidence which our learned friends rely upon most strongly, which is to suggest that there were negotiations that took place at a point to try and bring a ceasefire to this war, you can only bring an end to a war if you have some recognition that there is a war that is underway. So unless one is going to conceive of the notion that in this market in the 18 months preceding the merger you have two firms that are engaging in unprofitable activities, both of them are losing enormous amounts of money on an unsustainable basis and at a point they come together to say, "Shall we bring about an end to this bloodletting in the market" is a clear recognition that what is happening here is wholly unsustainable.

So, putting aside the question of labels as to whether one likes the word "abnormal" or not, all that is being captured here is a concept which says what was going on in that period was not ordinary profit maximising behaviour by these two firms, it was unsustainable conduct. It seems to have been recognised as such by the parties and consequently that is not a good guide to how we should construct the counterfactual.

So reading on in 6.4 the following is then said:

> "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' ..."

So the reasoning says, "We will not consider this to be a failing firm, we reject that form of analysis because, for the reasons that are offered in 6.4, we cannot conceive of what has happened in that period and the parlous state that PBL has come to as a construct that is useful for the purposes of determining the counterfactual". On both grounds, a rejection of the failing firm and an adoption of a counterfactual that was not based on the 18 months, the reasoning is reflected in 6.4.

Then 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."

In other words, that is the correct benchmark. Lest there be any doubt as to that conclusion in 6.6, if one reads on after the various options that were available to the parties, it is plain that in the conclusion that then follows in 6.13:

> "We therefore concluded ..."

and important words, in our submission –

> "... that the appropriate benchmark against which to assess the competitive effects of the merger ..."

In other words, the very statutory test that everyone clearly recognises in s.35(1) –

> "... to assess the competitive effects of the merger was the competitive situation which prevailed before the launch of the new intra-urban services by Stagecoach in 2007. PBL would most likely have continued to operate buses in Preston in much the same 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 or another."

A great deal of ink has been spilt as to precisely what is entailed by "profitable" in one or another, and I shall deal in due course with what is reasonably contemplated in this decision by that notion.

From the perspective of the counterfactual, what is being said here is simply that in the judgment of the Commission what is most likely is the reversion, that the merger did not go ahead, to a situation of normality.

Now, our learned friend has said on numerous occasions that that must be perverse because it entails the notion of Stagecoach exiting the market. We have puzzled greatly over that repeated reference by him to that notion because it fundamentally flies in the face of the market definition which was found by the Commission and is not contested in these proceedings; and perhaps I can take you to that.

THE CHAIRMAN: I think we clarified with him what he meant by that. He was not saying that they were going to stop buses in Preston at all. I think the point that we are interested in is that the Commission seems to have said, "What happened in the run up to the merger is abnormal competition, we do not think that was likely to continue in the absence of a merger over the future and so we disregard that as a counterfactual, therefore we think that things would have returned to where they were in June 2007". What concerns me at the moment, and I think my colleagues, is why did the Commission regard that as the only other option, rather than thinking, "Well, actually, things are most likely to have shaken down to something that was not as cut-throat and warlike as was going on before January 2009, but

gave Stagecoach the bigger share of the intra-urban bus passenger capacity than they had in 2007." Was that not the better and more likely factual, that, yes, there would be two operators on the market, but the split of business, if I can put it like that, would be different and more favourable to Stagecoach than it was before June 2007?

MR. UNTERHALTER: The question is, in our submission, answered by the fact that the Commission considered a number of possibilities, but did not have to conclude ultimately on any of them. When it refers in the passage that I have just read to the fact that it would have continued in one or another, whether as – I need to pick up the language, "Stagecoach would also have been most likely to continue to operate on its old routes while seek improved profitability in one way or another". We submit that nothing about that conclusion precludes the notion that Stagecoach would have had, or might have in the future, absent the merger, some greater share of the intra-urban routes. That logically flows from a good deal that is said about the way in which the market has been structured and the kind of equilibrium that existed in 2007. In 2007 there is a fairly detailed account that is given as to how the market was structured, but in essence it has made perfectly clear that although at that stage there is roughly a division between one firm that has the inter-urban routes and the other that has the intra-urban routes, it has also made perfectly clear that each of the firms is a constraint on the other so that they are competitors within the single market, and that is predicated on the threat of entry of each into the other's market, but particularly because there is a asymmetrical form of interaction where Preston, in particular, was deeply concerned - and this again seems common ground - by the threat that Stagecoach would enter the market. So, there seems little doubt that under the conception of 'the market' as the Commission saw it might be, absent the merger, that Stagecoach would, and could, be a presence on the intra-urban market. There is nothing that precludes that view from the way in which the decision is postulated. In other words, it is simply conceiving of a proxy for what the market will look like, which is effectively that the market will look less like the abnormal competition and it will revert back to a position -- Well, revert is not quite the right word. It will look like a situation that is more akin to the market dynamics and the equilibrium that was established in 2007.

Now, that is consistent with a large number of possibilities, which is that there could have been disposals of routes; there could have been a continuation of the equilibrium; there could have been some entry into the intra-urban routes in a more normalised way. But, that is the view that the Commission took. There seems no reason in principle - though this is a factual question rather than a legal question - as to why, when two competitors have been at

war in an abnormal way, there should not be some change ultimately to that war which permits of a number of different possibilities.

For the purposes of the merger, all that needs to be found is that the period of abnormal competition is not a good proxy for the future. The alternative is simply that there will be something more like normalised competition with a number of possible permutations, but under any of those permutations this merger will become deeply problematic because once one examines the counter factual without using the eighteen month period as the proxy, then one has simply got a classical position of a merger to monopoly. So, it takes very little.

This is partly why it is of the essence of Stagecoach's argument that they must confine the reasoning to the notion that what happens on a particular day is the only thing that counts for the purposes of trying to determine what is happening in the market and what the effects of the merger are, because any broader consideration leads them into the huge difficulty that the only kind of competition that was taking place in this market was going to be eliminated by virtue of the merger. Consequently, one can understand that, in our submission, the reasoning of the Commission is to try and understand what would be the prospects on this market without the merger and whether it is exactly the kind of equilibrium that existed in 2007 or a variant of it as between two competitors in the market. That has to be a situation that is vastly better and less anti-competitive than a situation of merger to monopoly. That is the fundamental reason, in our submission, that goes into the counterfactual.

We submit that once one takes the actual reasoning as opposed to a gloss on the reasoning, then it seems very hard to sustain Ground 1.

PROFESSOR BAIN: Can I just ask you two questions about this? The first is: At 6.13 you are referring to improving profitability in 'one way or another'. That is a phrase which I think came from [Stagecoach employee] in evidence, which was really in the context of not trying to increase market share quickly. It was doing other things. If that is read in that context it does seem to include major expansion of market share by Stagecoach. Would you accept that?

MR. UNTERHALTER: I am not certain that we would accept that. Although the passage from [Stagecoach employee] is one instance of an alternative available to Stagecoach which was to try and reduce costs rather than engage on a strategy of further market entry into a segment of the market, there seem to be a number of other possibilities that are postulated at different times, including selling the depot, for example, or selling the business altogether, or, indeed, possibly I suppose entering the market in some form, but clearly not in a form that took place under conditions of abnormal competition.

PROFESSOR BAIN: Thank you for that answer. My second question has to do with the position in 2007. Now, competition has, let us say, two separate dimensions. One is that you have got two companies that are watching each other, are liable to be getting a little bit of business from each other in one place or another, have prices at a level that allow them to operate reasonably profitably -- These are the conditions that we regard as normal competition. The other aspect of June 2007 is that one company has about 90 percent of the market and the other has about 10 percent. That particular aspect had changed quite dramatically by the time it came to the merger. Now, what you seem to me to be saying by taking 2007 as your counterfactual is that you expect in future that the general conditions in the market will settle down -- your periods of cut-throat competition are rare; they do not go on for terribly long; the normal situation is where people are watching each other and competing to a degree on the margins. That is the normal situation. That is what you expect to prevail. I do not have any issue with that.

However, the other aspect - this business of the market shares -- It seems to me difficult to argue that the market shares from which you start for your counter-factual should be those that happen to be the place in 2007 unless for some reason you want to push Stagecoach back from the gains in the market share that they achieved through their perfectly lawful conduct in the intervening period.

MR. UNTERHALTER: I think our submissions are the following on that: the first is that we would return to what the definition of the market is, which is captured in 7.21 of the Decision. "In relation to commercial services, from the demand-side perspective, the relevant market could therefore be defined as the supply of services on point-to-point journeys within the Preston area, We, however, recognised that there was scope for supply-side substitution. Given that Stagecoach and PBL were the only two competitors with significant frequently that were either actually or potentially present on each flow, we found it convenient to aggregate the competitive conditions on individual flows for the purposes of our competitive assessment and consider the supply of commercial bus services in the Preston area as a whole".

PROFESSOR BAIN: The shorthand for the point-to-point services is the intra-urban services, is it not, within the Preston area?

MR. UNTERHALTER: With respect, that market definition is inter and intra.

PROFESSOR BAIN: Inter is point-to-point within the ----

MR. UNTERHALTER: That was one of the considerations, but it is perfectly clear - and I will get the other references for this - that it was treated in some detail in Appendix J, I believe.

In any event, in our submission, it is clear that what was being contemplated, particularly when the question of the competitive interaction between these firms was being considered as to who was a constraint on who, that it was for commercial bus services in the Preston area. There are not two markets - intra and inter - with some competitive interaction or overlap between the two. There is a single definition (in Appendix I) - that there is a treatment of market definition.

THE CHAIRMAN: I do not think that detracts from Professor Bain's point, which is that say it is the intra-urban sector rather than the intra-urban market, given that in 2007 there was such an imbalance between the business operated on the intra-urban route by Stagecoach. Given what had happened during the period of what you call "abnormal" or, say, short term bus war competition, did it make sense to have a counterfactual which saw Stagecoach returning to that small part of the business rather than keeping at least some of its games. I can see that you see "Well, it does not matter to us" because you are still comparing a counterfactual where you have two competitors and it is down to a monopoly, so our finding that there was a significant lessening of competition might well stand even if Stagecoach kept 50 per cent of their gains, but clearly it would have a significant effect on the divestiture package that you would put together at the end of the day because that is really the effect of the counterfactual beyond using it as a basis on which to decide there was in fact a substantial lessening of competition?

MR. UNTERHALTER: I think we would accept that if one could be clear about how much precisely Stagecoach would under normal conditions of competition have kept off the intra-urban routes upon which it entered, then that might have certain consequences for the remedy. But the submission we would make on this score is this: once one has taken account of what was unsustainable competition and, in our submission, wholly unprofitable intervention by Stagecoach on the market, then there are a number of possibilities as to what a firm, once the war comes to an end, would do. Amongst them, and ordinarily one would have thought on a profit maximising principle you would say: "We have had this war, unusual competition taking place, why will we remain on routes which are unsustainable and unprofitable, recalling that the alleged rationale for engaging in this competition, at least according to Stagecoach was to try and make up for the substandard performance of the Preston depot. Well how it is that one will incur very substantial additional losses on a total allocated cost basis of over £[X] in order to try and make up the substandard performance of the depot is very hard to conceive of as a rational strategy. So assuming that the factual underpinnings of the notion of unsustainable competition are correct, and we

will come to that, then we submit there could be a number of permutations, one of which is simply that Stagecoach would say we are not going to carry on on routes that simply do not make a proper return, that is not profit maximising behaviour, we had committed ourselves during the bus wars to buying these buses without any hope of return on that investment, and again I shall come to that part of the profitability analysis, come to that issue, but at the moment we are just analysing the legal test. Under the legal test if it was a construct that was available on the evidence that was before the Commission then at least one permutation is they would draw back.

THE CHAIRMAN: I think we will finish there. That has been very helpful to take it that far. Thank you very much. How much longer, Mr. Unterhalter – it is rather an unfair question – can we assume that we will go into tomorrow afternoon?

MR. UNTERHALTER: I should think that is likely. We will review overnight where the emphasis in the argument now lies, and there is a lot of perhaps material that we can now I think move past relatively quickly and simply try and focus on the key parts of what now appear to be Stagecoach's argument. But I do fear it is likely to take a good part of the morning at any rate.

THE CHAIRMAN: Yes, thank you. We will meet at 10.30 again tomorrow morning.

(Adjourned until 10.30 a.m. on Wednesday, 10th March 2010)